Setting Attorneys' Fees in Securities Class Actions: An Empirical Assessment

*Lynn A. Baker**
*Michael A. Perino***
*Charles Silver****

---

* Lynn A. Baker (lbaker@law.utexas.edu) holds the Frederick M. Baron Chair in Law at the School of Law at the University of Texas at Austin. Professor Baker serves as a consultant to law firms that handle class actions, including securities class actions, and serves as an expert witness on matters relating to attorneys' fees.

** Michael A. Perino (perinom@stjohns.edu) is the Dean George W. Matheson Professor of Law at St. John's University School of Law. In the past, Professor Perino has served as an expert witness on matters relating to attorneys' fees in securities class actions.

*** Charles Silver (csilver@law.utexas.edu) holds the Roy W. and Eugenia C. McDonald Endowed Chair in Civil Procedure at the School of Law at the University of Texas at Austin. Professor Silver consults with law firms that handle class actions, including securities class actions, and serves as an expert witness on matters relating to attorneys' fees.

This article was prepared for the Institute for Law & Economic Policy 19th Annual Symposium on "The Economics of Aggregate Litigation," held on April 11–12, 2013, in Naples, Florida, and also benefited from presentation at a Faculty Colloquium at the University of Texas School of Law. The authors would like to thank Cornerstone Research and Stanford Law School for access to data from the Securities Class Action Clearinghouse, Jim Cox for inviting them to participate in the ILEP Conference, and Brian Fitzpatrick for formally commenting on the conference draft. The authors are also grateful for valuable comments from Oren Bracha, Michael Churgin, Jens Dammann, Nancy Fineman, Jill Fisch, Mira Ganor, Carol Gilden, John Golden, Mark Gross, Henry Hu, Angie Littwin, Marian Rosner, Bill Sage, James Spindler, Jordan Steiker, Randall Thomas, Jay Westbrook, and Abe Wickelgren. They would like to thank the following University of Texas law students who provided valuable assistance with data collection: Justin Bryant, Ben Cukerbaum, Elizabeth Eoff, Brett Goodman, Gen Li, Tianyu Ma, Matt Manning, Ryan Meyer, Ima Nsien, Min Yoon, and Yongjin Zhu. The authors are grateful to Michael Fischel for research assistance, and to University of Texas law librarians Casey Duncan and Matt Steinke for providing assistance with the Bloomberg and Pacer databases. Finally, the authors would like to thank the following attorneys who provided copies of court papers filed in some of the cases discussed in this Article: Ramzi Abadou, Andrew Brown, Jeff Campisi, Nancy Fineman, Jonathan Gardner, Kim Miller, Laurence Rosen, and Marian Rosner. The views expressed in this paper are solely the views of the authors and do not represent in any way the views of Cornerstone Research, Stanford Law School, or any of the individuals acknowledged in this footnote.

I. INTRODUCTION

In 1995, Congress overrode President Bill Clinton's veto and enacted the Private Securities Litigation Reform Act ("PSLRA"), a key purpose of which was to put securities class actions under the control of institutional investors with large financial stakes in the outcome of the litigation.[1] The theory behind this policy, set out in a famous article by Professors Elliot Weiss and John Beckerman,[2] was simple: self-interest should encourage investors with large stakes to run class actions in ways that maximize recoveries for all investors. These investors should naturally want to hire good lawyers, incentivize them

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.); *see* 15 U.S.C. §§ 77z-1(a)(3), 78u-4(a)(3) (2012) (establishing procedural guidelines for determining lead plaintiffs); 141 CONG. REC. S19,180 (daily ed. Dec. 22, 1995) (noting the Senate override); 141 CONG. REC. H15,214, H15,223-24 (daily ed. Dec. 20, 1995) (noting the House override); Presidential Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act of 1995, 31 WEEKLY COMP. PRES. DOC. 2210 (Dec. 19, 1995) (veto).

2. Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2105 (1995).

properly, monitor their actions, and reject cheap settlements. In other words, control by large investors should reduce agency costs, which can be severe when securities class actions are run by lawyers who may be essentially unsupervised because their clients' stakes are small. This reduced risk of opportunism should alleviate the need for judges to police the conduct of class counsel as well.

By giving large investors control of securities-fraud class actions, the PSLRA expresses greater confidence in private arrangements than in judicial regulation, which failed to protect investors sufficiently in the past. Initially, Congress's confidence in private arrangements seemed misplaced because institutional investors rarely volunteered to serve as lead plaintiffs.[3] The statute created no incentives motivating them to serve,[4] so they remained on the sidelines as they had before.[5] Over time, however, a series of developments brought more public pension funds into the fray.[6] The publicity that attended the scandals involving Enron, WorldCom, Tyco, and Cendant likely played an important role, as did the enormous recoveries obtained in those cases.[7] Lawyers seeking appointments as lead counsel also contributed by building relationships with institutional investors. Law firms wined and dined

---

3. *See* OFFICE OF THE GEN. COUNSEL, U.S. SEC. & EXCH. COMM'N, REPORT TO THE PRESIDENT AND THE CONGRESS ON THE FIRST YEAR OF PRACTICE UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 § VI(C)(1) (1997), *available at* http://www.sec.gov/news/studies/lreform.txt (examining the effects of the PSLRA).

4. *See* Joseph A. Grundfest & Michael A. Perino, *The Pentium Papers: A Case Study of Collective Institutional Investor Activism in Litigation*, 38 ARIZ. L. REV. 559, 603–04 (1996) (describing the shortcomings of the PSLRA in incentivizing institutional investors to serve as plaintiffs).

5. The SEC found that institutions served as lead plaintiffs in only 8 of 105 cases filed in the first year after passage of the PSLRA. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 3.

6. By 2002, public and union pension fund participation had grown to 27.2% of filed cases. PRICEWATERHOUSECOOPERS LLP, 2005 SECURITIES LITIGATION STUDY 21 (2006). The percentage peaked in 2007 at 57%. PRICEWATERHOUSECOOPERS LLP, THE EVER-CHANGING LANDSCAPE OF LITIGATION COMES FULL CIRCLE 2011 SECURITIES LITIGATION STUDY 27 (2012), *available at* http://www.pwc.com/en_US/us/forensic-services/publications/assets/2011-securities-litigation-study.pdf. In subsequent years, institutions appeared as lead plaintiffs in just under 40% of filed cases, a substantially higher rate than before passage of the PSLRA. *Id.*; *see also* Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471, 472 (2007) (discussing the failure to build into the PSLRA incentives for investors to participate as lead plaintiffs).

7. For discussions, see Stephen J. Choi, A. C. Pritchard & Jill E. Fisch, *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869, 879 (2005) (identifying factors that impacted institutional participation); Michael Perino, *Institutional Activism Through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions*, 9 J. EMPIRICAL LEGAL STUD. 368, 375 (2012) (discussing role of corporate scandals in incentivizing institutional participation).

investment managers, volunteered to monitor institutional portfolios for signs of fraud, and made campaign contributions to politicians who had influence or control over public pension funds in what some have suggested are pay-to-play relationships.[8] Today, institutional investors are important players in securities-fraud class actions.

Now that institutional investors are participating more often, it remains to consider whether the mechanism created by the PSLRA is working as anticipated. Are large investors improving the performance of securities class actions by reducing agency costs? The early evidence was inconclusive. Researchers initially found that "institutional participation . . . correlated with larger settlements,"[9] but it was not clear whether "this result [was] really the product of enhanced institutional monitoring" rather than of cherry-picking by institutions, which preferred to become involved in cases that were larger and easier to pursue.[10] Recently, however, one of us (Perino) studied a large and rich data set of settled securities class actions. Perino found that public institutional investors extracted larger recoveries on securities-fraud claims than other types of lead plaintiffs, even controlling for case characteristics, and exerted economically significant downward pressure on fees. "On average, fee requests [were] 5.3 percent less and fee awards [were] 3.4 percent less than in cases without public pension funds [as the lead plaintiff]."[11]

Moreover, participation by these kinds of institutional investors may have had an important spillover effect. As fee awards declined in cases led by public pension funds, they also fell in other securities class actions.[12] Federal district court judges may provide the connection. Opinions and orders in cases with institutional lead

---

8. On the role of "pay-to-play" arrangements, see Stephen J. Choi, Drew T. Johnson-Skinner & A.C. Pritchard, *The Price of Pay to Play in Securities Class Actions*, 8 J. EMPIRICAL LEGAL STUD. 650, 678 (2011); Silver & Dinkin, *supra* note 6, at 478–88; David H. Webber, *Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions?*, 90 B.U. L. REV. 2031, 2080–81 (2010).

9. James D. Cox & Randall S. Thomas, *Does the Lead Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1588–93 (2006); James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 367 (2008);. Perino, *supra* note 7, at 369–70 (citing C.S. Agnes Cheng et al., *Institutional Monitoring through Shareholder Litigation*, 95 J. FIN. ECON. 356 (2010)).

10. Choi et al., *supra* note 7, at 900–01. To the extent that this cherry-picking means that the "better" cases were pursued more vigorously, and less good cases were pursued less frequently, that would also be likely to result in a net social gain.

11. Perino, *supra* note 7, at 369.

12. *Id.* at 370.

plaintiffs are more likely to be published.[13] Fee awards in securities class actions are also closely followed by academics.[14] Both sources make it relatively easy for district court judges (and the lawyers and experts who appear before them) to follow trends in fee regulation. In effect, dissemination of information regarding the fees that sophisticated institutional investors negotiated with class counsel may create a market for fees where one did not exist before. Courts could then rely on those market rates for setting fees in securities cases led by individual investors, union funds, and others.

There is, then, important evidence that the mechanism created by the PSLRA is reducing certain agency costs. *Why* it is doing so is unclear, however. As Professors Choi, Fisch, and Pritchard explain: "The theory [underlying the lead-plaintiff provision of the PSLRA] was that an institutional investor with a substantial damages claim would have the incentive to bargain hard with class counsel on behalf of the class, reducing the percentage of the recovery awarded to class counsel."[15] Is the predicted bargaining over attorneys' fees occurring? Or might agency costs be lower in securities class actions led by institutional investors for a different reason? An alternative mechanism could run through judges. The presence of an institutional investor could signal to the presiding judge that a case is especially meritorious, entailing a lower risk of nonrecovery. The judge might then demand better performance from class counsel or award lower fees. If judges are responsible for reduced agency costs, however, the PSLRA is not working as intended. Public regulation, rather than private ordering, still carries the load.

To learn how the mechanism created by the PSLRA is working on the ground, we studied securities class actions that settled between 2007 and 2011 in the three federal district courts that processed the largest numbers of these cases: the Central District of California, the Northern District of California, and the Southern District of New York. Briefly stated, we found little evidence that ex ante fee agreements play a role in the process for selecting lead plaintiffs.[16] At the settlement-approval and fee-award stages, however, we found that

---

13. *Id.* at 373.

14. For recent studies of fee awards in class actions generally, see Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL LEGAL STUD. 248, 248–52 (2010); Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. 811, 811–14 (2010).

15. Choi et al., *supra* note 7, at 869–70.

16. By an "ex ante fee agreement," we mean an agreement regarding attorneys' fees whose terms are negotiated prior to the filing of an investor's application to be appointed lead plaintiff.

lawyers more frequently invoked such agreements to support their requested fee and that courts deferred to attorneys' fee requests more often in cases with evidence of an ex ante fee agreement. We further found evidence of an ex ante fee agreement or of a proxy for such an agreement (specifically, the presence of a public pension fund as the lead plaintiff) to be correlated with statistically and economically significant reductions in fee requests and awards, as well as with greater judicial deference to the requested fee. Overall, the court awarded a lower fee than the class counsel requested in about 18% of the cases we reviewed, a somewhat higher percentage than we had anticipated.

This Article proceeds as follows: Part II describes the selection mechanisms for lead plaintiff and class counsel contained in the PSLRA and shows how they might facilitate ex ante fee setting. Part III sets out our study design and discusses our empirical findings in greater depth. Part IV contains brief concluding remarks.

II. THE PSLRA'S MECHANISMS FOR SELECTING THE LEAD PLAINTIFF AND CLASS COUNSEL AND FOR SETTING ATTORNEYS' FEES

When it enacted the PSLRA, Congress sought to use institutional investors' superior information and incentives to improve the operation of securities class actions.[17] Because institutional investors are sophisticated clients who can offer lawyers repeat business, they potentially have the ability to choose good class action lawyers, monitor them effectively, and bargain with them for lower fees.

The language of the PSLRA describes how the mechanism is supposed to work. After notice of a class action lawsuit is sent to all investors via publication in "[either a] widely circulated national business-oriented publication or wire service," investors interested in serving as lead plaintiff have sixty days to file motions nominating themselves for the position.[18] The trial court judge must then review any competing applications and is required to give control of the case to the "most adequate plaintiff" (i.e., the investor found to be the "most capable of adequately representing the interests of class members").[19]

17. H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 731 (noting Congress's intent to "increase the likelihood that parties with significant holdings in issuers, whose interests are more strongly aligned with the class of shareholders, will participate in the litigation and exercise control over the selection and actions of plaintiff's counsel").

18. 15 U.S.C. §§ 77z-1(a)(3)(A), 78u-4(a)(3)(A) (2012).

19. *Id.* §§ 77z-1(a)(3)(B)(i), 78u-4(a)(3)(B)(i).

The PSLRA imposes a presumption that the most adequate plaintiff is the applicant which has "the largest financial interest in the relief sought by the class" and which "otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure."[20] Once appointed, the lead plaintiff is required, "subject to the approval of the court, [to] select and retain counsel to represent the class."[21] Finally, the statute limits the total attorneys' fees and expenses that may be awarded to "a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."[22]

A. The PSLRA Requires Lead Plaintiffs to "Select and Retain" Class Counsel

The PSLRA's text and underlying policy suggest that a would-be lead plaintiff should address compensation when it selects lead counsel. The phrase "select and retain" implies that a lead plaintiff will do more than just choose a law firm to represent it and the other members of the class; it could be read to require a lead plaintiff to actually hire the law firm and set the terms of its compensation as well. This conclusion follows from the definition of "retain," which, when used in connection with lawyers, commonly refers to the payment of initial compensation, known colloquially as a "retainer," or to the act of engagement, which normally includes an agreement on the lawyers' compensation terms.[23] The conclusion that the word "retain" includes setting compensation also comports with the canon of statutory construction that multiple related words be given different

20. *Id.* §§ 77z-1(a)(3)(B)(iii)(I), 78u-4(a)(3)(B)(iii)(I).

21. *Id.* §§ 77z-1(a)(3)(B)(v), 78u-4(a)(3)(B)(v).

22. *Id.* §§ 77z-1(a)(6), 78u-4(a)(6).

23. The following dictionaries available online contain the indicated definitions of the transitive form of the verb "retain": *retain*, *v.*, OXFORD ENGLISH DICTIONARY 2(b), *available at* http://www.oed.com/view/Entry/164150#eid25737172 ("To engage (a lawyer, esp. a barrister) by the payment of a preliminary fee, in order to secure his or her services if required"); *retain* (*verb*), MERRIAM-WEBSTER UNABRIDGED 2(b), *available at* http://unabridged.merriam-webster.com/unabridged/retain ("[T]o keep in one's pay or service; specifically: to employ by paying a retainer"); *retain - definition*, MACMILLAN DICTIONARY 3, *available at* http://www.macmillandictionary.com/us/dictionary/american/retain ("[T]o employ a professional person such as a lawyer or doctor by paying an amount of money called a retainer before the work is done"); *retain*, OXFORD DICTIONARIES 4, *available at* http://oxforddictionaries.com/definition/english/retain?q=retain ("[(To] secure the services of (a barrister) with a preliminary payment"); *retain*, THE FREE DICTIONARY 4, *available at* http://www.thefreedictionary.com/retain ("To hire (an attorney, for example) by the payment of a fee"); *What is RETAIN*?, THE LAW DICTIONARY, http://thelawdictionary.org/retain/#ixzz2gbL7MCf8 ("To engage the services of an attorney or counselor to manage a cause").

meanings to avoid redundancies.[24] Because the PSLRA says that a lead plaintiff must "select and retain" class counsel, retention must include something more than identifying or choosing. The natural complement is hiring or engaging, which normally includes setting compensation terms.

If the preceding interpretation is correct, then the PSLRA anticipates that lead plaintiffs will set compensation terms for class counsel (subject to judicial review, as explained below). This assignment of responsibility makes sense because a sophisticated lead plaintiff with a large financial stake in the case and substantial experience in securities litigation should have good information about both the identity of the "right" lawyer for the case and the "right" fee for the lawyer to be paid. To obtain the best combination of quality and price, a plaintiff must evaluate the facts and bargain with attorneys. Sophisticated lead plaintiffs can do both because law firms compete openly for their business. This competitive process enables institutional investors to evaluate lawyers' track records and credentials, assess the "fit" between lawyer and client, compare requested compensation terms, and use the prospect of future business to extract concessions.

Evidence from the early days of institutional investor activism in securities class actions shows institutions engaging in this kind of sophisticated evaluative process. In 2002, Jill Fisch surveyed the practices that institutions employed when contemplating filing suit under the PSLRA and found that they largely mimicked the kind of arm's length bargaining that corporations used to retain counsel.[25] Among other things, anecdotal evidence showed that institutions sent out requests for proposals, conducted beauty contests, and fielded large numbers of unsolicited inquiries from law firms seeking to represent them in these cases.[26] Institutions generally sought to balance price and quality when selecting lead counsel and universally expressed an unwillingness to look solely at which firm submitted the

---

24. *See* Bd. of Trs. of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 131 S. Ct. 2188, 2196 (2011) (expressing the Court's general reluctance to treat statutory terms as surplusage); Bailey v. United States, 516 U.S. 137, 146 (1995) ("[W]e assume that Congress used two terms because it intended each term to have a particular, nonsuperfluous meaning."). It bears noting that states' professional disciplinary rules require contingent fee agreements to be "in a writing signed by the client" and to "state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal." *See, e.g.*, ABA MODEL RULES OF PROF'L CONDUCT R. 1.5(c) (2013).

25. Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 710 (2002).

26. *Id.* at 705–06.

lowest bid.[27] Nonetheless, the competition among qualified law firms gave institutions significant leverage in negotiating fee arrangements.[28] In conducting those negotiations, institutions were apparently quite sensitive to agency-cost issues.[29]

Professors Weiss and Beckerman anticipated that lead plaintiffs would handle fees differently than judges,[30] predicting that institutional investors might jettison the judicial practice known as "the increase/decrease rule," according to which the fee percentage declines as the recovery grows.[31] "To encourage its attorneys to pursue strong cases more vigorously, an institution might agree to pay them an increasing portion of any recovery in excess of some stipulated threshold . . . ."[32] In fact, some lead plaintiffs have used "increase/increase" fee arrangements.[33] Most famously, the Board of Regents for the University of California did so in the *Enron* litigation, which recovered $7.2 billion for investors.[34] After approving the settlement, Judge Melinda Harmon based the fee award on the sliding scale provided in the attorneys' fee agreement, which entitled the lawyers to 8% of the first $1 billion recovered, 9% of the second $1 billion, and 10% of all dollars recovered above that amount.[35] The total fee awarded was $688 million.[36]

B. Case Law Bearing on the Submission of Fee Agreements

In keeping with the analysis of the PSLRA offered in the preceding Section, some courts have encouraged trial judges to consider fee agreements when setting fees. *In re Cendant Corp. Litigation* is the most prominent case.[37] There, the Third Circuit

---

27. *Id.* at 706–08.

28. *Id.* at 708–09.

29. *Id.*

30. *See* Weiss & Beckerman, *supra* note 2, at 2107 (speculating that lead plaintiffs' preferred arrangements might "differ substantially from the fee structures that courts currently employ").

31. *Id.*

32. *Id.*

33. Under an "increase/decrease" regime, the percentage attorneys' fee declines as the size of the recovery grows. Under an "increase/increase" agreement, the opposite occurs; that is, the fee percentage rises as more dollars are recovered. Both arrangements typically set out various "tiers" for the gross recovery and corresponding attorneys' fees.

34. *In re* Enron Corp. Sec., Derivative & ERISA Litig., 586 F. Supp. 2d 732, 740 (S.D. Tex. 2008).

35. *Id.* at 769–78.

36. *Id.* at 740.

37. *In re* Cendant Corp. Litig., 264 F.3d 201 (3d. Cir. 2001).

rejected an attempt by a district judge to auction the role of lead counsel, pointing out that the PSLRA empowered the lead plaintiff "to select and retain" counsel for the class.[38] That allocation of authority made sense, the court wrote, because, "at least in the typical case, a properly-selected lead plaintiff is likely to do as good [as] or [a] better job than the court" when it comes to choosing counsel and setting fees.[39] The trial judge's job is to ensure that the lead plaintiff "fairly and adequately represent[s] the interests of the class."[40] "[O]ne of the best ways" a trial judge can do this, the Third Circuit wrote, is by "inquir[ing] whether [a lead plaintiff candidate] has demonstrated a willingness and ability to select competent class counsel and to negotiate a reasonable retainer agreement with that counsel."[41]

Somewhat surprisingly, the Third Circuit's explicit inclusion of fee-related matters in the adequacy assessment has not reduced the size of attorneys' fees that are requested or awarded. Just the opposite seems to have occurred. In a recent study, Eisenberg, Miller, and Perino found that fee awards in the Third Circuit were significantly higher than those in the Second Circuit, even controlling for case characteristics.[42] The Third Circuit was not exceptional in this regard. Eight other circuits also awarded fees significantly above those meted out in the Second Circuit.[43] However, the Third Circuit did stand out when it came to fee *requests*. It was the only circuit in which fee requests were significantly higher than those in the Second Circuit.[44] Although courts generally appeared to tread lightly when reviewing fee requests (on average awarding attorneys approximately 90% of their requested fees), there was some evidence that the Third Circuit was even more deferential.[45] The authors did not explore what, if any,

38. *Id.* at 275.

39. *Id.* at 276.

40. *Id.* at 266.

41. *Id.* at 265.

42. Theodore Eisenberg, Geoffrey Miller & Michael A. Perino, *A New Look at Judicial Impact: Attorneys' Fees in Securities Class Actions After* Goldberger v. Integrated Resources, Inc., 29 WASH. U. J.L. & POL'Y 5, 28 (2009).

43. *Id.*

44. *Id.*

45. *Id.* In the median case, the ratio of the fee award to the fee request was 1.00—the attorneys received exactly what they requested. *Id.* at 20. In the subsample of cases in which the court awarded something less than the requested fee, the coefficient for the Third Circuit variable was positive and significant, meaning that in those cases, district courts in the Third Circuit awarded attorneys a greater proportion of the requested fees than courts in the reference group of Second Circuit cases. *Id.* at 30. Again, however, the Third Circuit was not alone. *Id.* The other circuits where the variable was positive and significant were the Fifth, Sixth, Seventh, Tenth, Eleventh, and D.C. Circuits. *Id.*

causal link exists between the Third Circuit's standard for selecting lead plaintiffs and the fee requests and awards in that jurisdiction.

One difficulty in establishing such a link is that courts outside of the Third Circuit rarely consider retainer agreements or other evidence of hard bargaining when assessing the adequacy of a proposed lead plaintiff.[46] One exceptional case is *In re Razorfish Securities Litigation*.[47] There, Judge Rakoff rejected a proposal to auction the role of lead counsel as being inconsistent with the statutory language and far too intrusive.[48] As in *Cendant*, however, the court still saw a role for itself, although in doing so it blended together the technically distinct tasks of selecting the lead plaintiff and approving the lead plaintiff's choice of lead counsel. Noting that an "excessive compensation proposal can cast in doubt the ability of proposed lead counsel to adequately represent the class," the court required the prospective lead counsel to submit its negotiated fee arrangements under seal.[49] After review, Judge Rakoff found that one proposal "was excessive both in terms of the other submissions and in terms of the nature of this particular case" and offered that counsel an opportunity to resubmit.[50] Counsel then submitted a lower proposal.[51] In the court's view, this kind of gentle nudge was preferable to having the judge at the center of the process of picking counsel and setting fees.[52] "Unlike an auction system," Judge Rakoff wrote, "such modest

---

46. *See In re* Luxottica Grp., S.P.A. Sec. Litig., No. 01-CV-3285, 2004 U.S. Dist. LEXIS 21130, at *13–20 (E.D.N.Y. Oct. 22, 2004) (looking to the retainer agreement when approving the lead plaintiff's choice of lead counsel); Craig v. Sears Roebuck & Co., 253 F. Supp. 2d 1046, 1049–50 (N.D. Ill. 2003) (considering fee agreements and other evidence of negotiation in assessing the proposed lead plaintiff); *In re* Royal Ahold N.V. Sec. & ERISA Litig., 219 F.R.D. 343, 354 (D. Md. 2003) (looking to fee agreement in choosing the lead plaintiff from among the remaining movants); Taft v. Ackermans, No. 02 Civ. 7951(PKL), 2003 WL 402789, at *1 n.1 (S.D.N.Y. Feb. 20, 2003) ("[I]f the proposed fee agreement was outside the bounds of reason, that would certainly be evidence that the proposed lead counsel would not fairly represent the class."); Raftery v. Mercury Fin. Co., No. 97 C 624, 1997 U.S. Dist. LEXIS 12439, at *7 (N.D. Ill. Aug. 7, 1997) ("[W]hile the statute does provide for the award of fees based on the ultimate recovery, this court does not believe this statutory language prevents the court from considering what an attorney expects to take from the recovery in determining whether the presumptively most adequate plaintiff is in fact the most adequate plaintiff.").

47. *In re* Razorfish, Inc. Sec. Litig., 143 F. Supp. 2d 304 (S.D.N.Y. 2001).

48. *Id.* at 311. With respect to whether auctions were permitted under the PSLRA, the court noted that "[b]y no reasonable reading of this language can the Court's right to disapprove lead plaintiff's choice of counsel be transmogrified into a right to arrange a shot-gun marriage between strangers." *Id.* at 310.

49. *Id.* at 311.

50. *Id.*

51. *Id.*

52. *Id.*

intervention by the Court is fully consistent with the mandate of the Reform Act that the lead plaintiff's selection and retention of counsel be subject to a court approval that is meaningful and not simply perfunctory."[53]

The cases where the court explicitly considered evidence of ex ante bargaining over fees to be relevant in appointing the lead plaintiff are a tiny minority. Even when investors compete for the lead plaintiff position—and where success might conceivably depend on proof that one negotiated the best fee terms for the class—most courts do not make a deep or searching inquiry into the matter. Victory turns almost exclusively on which candidate has the largest financial interest.[54] The candidate who wins this battle usually garners the position and need only show that its choice of counsel and negotiated fee terms are reasonable.[55]

Given that the size of investors' financial stakes carries most of the weight in the battle to be appointed the lead plaintiff, the relative unimportance of information about fees is unsurprising.[56] In many

---

53. *Id.*

54. *See* MICHAEL A. PERINO, SECURITIES LITIGATION UNDER THE PSLRA § 2.04 B.1 (2012) ("The key issue in applying the most adequate plaintiff presumption is determining which plaintiff has the largest financial interest in the relief sought by the class.").

55. *See, e.g.*, Herrgott v. U.S. Dist. Court (*Cavanaugh*), 306 F.3d 726, 732–33 (9th Cir. 2002) (reversing the district court's denial of the position of lead plaintiff to the candidate with the largest financial interest because the candidate's choice of counsel and fee arrangement was reasonable and the district court had no authority to select for the class what it considered to be the best lawyer or fee schedule).

56. In some cases, the financial stakes are so far apart that the class member with the smaller stake withdraws its motion or puts up only token opposition to the motion of the presumptively most adequate plaintiff. *See, e.g.*, City of Roseville Emps. Ret. Sys. v. Horizon Lines, Inc., No. 08-969, 2009 U.S. Dist. LEXIS 62572, at *2 (D. Del. June 18, 2009) (stating that a class member withdrew its motion for appointment as lead plaintiff upon reviewing a motion for lead plaintiff by another member with a larger financial interest in the case). In cases where the stakes are similar in size, however, there is often a spirited fight over such matters as the proper accounting measure to be used to calculate the largest financial interest. *See, e.g.*, Ellenberg v. JA Solar Holdings Co., 262 F.R.D. 262, 265–66 (S.D.N.Y. 2009) (determining which investor had the largest financial interest without regard to competing accounting methods when one investor argued that the use of "First-In, First-Out" ("FIFO") instead of "Last-In, Last-Out" ("LIFO") overstated the other investor's loss); *In re* Doral Fin. Corp. Sec. Litig., 414 F. Supp. 2d 398, 403 n.7 (S.D.N.Y. 2006) (recognizing the difficulty of determining the largest financial stake when it was not clear which accounting methods the parties used and stating that FIFO has fallen out of favor in the district due to its "tendency to overstate the losses of institutional investors and to understate gains made from stock sold during the class period"). Other cases examine whether in-and-out trades during the class period should be included in the calculation, *see In re* K-V Pharm. Co. Sec. Litig., No. 11CV01816 AGF, 2012 WL 1570118, at *4 (E.D. Mo. May 3, 2012) (holding that courts should look only at "recoverable losses caused by the alleged fraud-on-the-market when determining lead plaintiff in a securities class action"); Perlmutter v. Intuitive Surgical, Inc., No. 10-CV-03451-LHK, 2011 U.S. Dist. LEXIS 16813, at *17 (N.D. Cal. Feb. 15, 2011) (holding that a likely inability to prove loss causation "make[s] it less likely that

cases, the evidence concerning a lead plaintiff's choice of counsel appears to consist of little more than the prospective lead counsel's firm resume.[57] Although the PSLRA permits discovery into matters bearing on the adequacy of a candidate for lead plaintiff,[58] discovery rarely occurs in practice. And without discovery, class members hoping to show that the candidate with the largest stake is inadequate are unlikely to possess information about fee arrangements unless the presumptive lead plaintiff volunteers it or the court asks for it.

Nor is a class member competing for the role of lead plaintiff likely to establish the inadequacy of the candidate with the largest financial stake by showing that it negotiated better fee terms for the class. Under prevailing law, to keep the presumption of adequacy, the candidate with the largest stake need only retain counsel on *reasonable* terms, not the *best* terms. In *In re Cavanaugh*, for example, the court found that it had no authority to select

> what it considers to be the best possible lawyer or the lawyer offering the best possible fee schedule. . . . Rather, such information is relevant only to determine whether the presumptive lead plaintiff's choice of counsel is so irrational, or so tainted by self-

---

plaintiffs can recover losses incurred prior to the disclosure of a defendant's fraudulent conduct and thus provide greater justification for excluding those losses in any calculation of a potential lead plaintiff's financial interest in the litigation."), whether the calculation should include any postclass increase in the stock price, *compare* Foley v. Transocean Ltd., 272 F.R.D. 126, 130 (S.D.N.Y. 2011) (advocating use of PSLRA bounce back rule), *with In re* Gen. Elec. Sec. Litig., No. 09 Civ. 1957(DC), 2009 WL 2259502, at *5 (S.D.N.Y. July 29, 2009) (using bounce back rule to determine largest financial interest), and even what the appropriate class period should be, *compare In re* Telxon Corp. Sec. Litig., 67 F. Supp. 2d 803, 818–19 (N.D. Ohio 1999) (holding that the largest financial interest must be based on the class period stated in the notice for the first filed action), *with In re* BP, PLC Sec. Litig., 758 F. Supp. 2d 428, 434 (S.D. Tex. 2010) (holding that the longest, most inclusive class period should be used because it encompasses more potential class members).

57. *See, e.g.*, Bassin v. deCODE genetics, Inc., 230 F.R.D. 313, 317 (S.D.N.Y. 2005) (determining the adequacy of the lead plaintiff's counsel based on the submission of the attorney's resume indicating that the attorney had previously served as lead counsel in several securities-fraud class actions and the fact that the attorney was free of conflicts).

58. To obtain discovery on the most adequate plaintiff issue, a plaintiff must demonstrate "a reasonable basis for a finding that the presumptively most adequate plaintiff is incapable of adequately representing the class." 15 U.S.C. §§ 77z-1(a)(3)(B)(iv), 78u-4(a)(3)(B)(iv) (2012); *see* Hodges v. Immersion Corp., No. C-09-4073 MMC, 2009 U.S. Dist. LEXIS 122565, at *12–13 (N.D. Cal. Dec. 21, 2009) (holding that a putative class member was not entitled to discovery where the class member did not present any evidence to support theory that presumptive lead plaintiff would be incapable of adequately representing the class); *In re* Tronox, Inc., 262 F.R.D. 338, 347–48 (S.D.N.Y. 2009) (denying request to conduct limited discovery where plaintiff did not demonstrate a reasonable basis for it and noting that "such discovery will only cause unnecessary delay and expense" and is "likely to provide results that are neither helpful nor likely to change the outcome").

> dealing or conflict of interest, as to cast genuine and serious doubt on that plaintiff's willingness or ability to perform the functions of lead plaintiff.[59]

As a result, the *In re Cavanaugh* court held that adequacy under Rule 23(a) cannot be judged according to "how advantageous an attorney's fee deal [the prospective lead plaintiff] manages to negotiate."[60] Under this standard, information about fee terms can have little value in the competition for the lead plaintiff role.

C. Summary

Sophisticated clients use contingent fee agreements negotiated at the outset of a representation to set market-based compensation terms that motivate lawyers to maximize gains. When Congress enacted the PSLRA, it appears to have wanted lead plaintiffs to use the same approach in securities class actions. This view fits nicely with the statutory language requiring lead plaintiffs to "select and retain" counsel for the classes they head.

The extent to which existing practices comport with Congress's desire is not known. Only the Third Circuit requires district court judges to consider fee agreements when appointing lead plaintiffs, but even there, many district courts do not seem to do so.[61] The reported

---

59. *Cavanaugh*, 306 F.3d at 732–33 (citations omitted). Some district court decisions in the Ninth Circuit prior to *In re Cavanaugh* appeared to conduct a much more searching inquiry, similar to the Third Circuit approach, with respect to the fees negotiated between the lead plaintiff and the proposed lead counsel. *See* Armour v. Network Assocs., 171 F. Supp. 2d 1044, 1055 (N.D. Cal. 2001) (appointing the class member with the largest financial interest as lead plaintiff after performing an in camera review of the fee arrangement and determining it was reasonable); *In re* Quintus Sec. Litig., 201 F.R.D. 475, 487–88 (N.D. Cal. 2001) (denying the position of lead plaintiff to the class member with the largest financial interest because the court concluded that another class member had negotiated a more favorable fee arrangement with counsel).

60. *Cavanaugh*, 306 F.3d at 732.

61. *See* Steamfitters Local 449 Pension Fund v. Cent. European Distribution Corp., No. 11-6247 (JBS/KMW), 2012 U.S. Dist. LEXIS 118693, at *4 (D.N.J. Aug. 22, 2012) (accepting the magistrate judge's recommendation to approve the lead plaintiff's choice of counsel without a discussion of fee arrangements when the motion to appoint counsel was unopposed); Blake Partners, Inc. v. Orbcomm, Inc., No. 07-4517, 2008 U.S. Dist. LEXIS 43061, at *21–26 (D.N.J. June 2, 2008) (noting that the Third Circuit requires courts to consider "whether the movant has demonstrated a willingness and ability to . . . negotiate a reasonable retainer agreement with that counsel" but neglecting to discuss the movant's fee arrangement); *In re* Sterling Fin. Corp. Sec. Class Action, No. 07-2171, 2007 U.S. Dist. LEXIS 93708, at *15–16 (E.D. Pa. Dec. 21, 2007) (determining without describing the fee arrangement that the proposed lead plaintiff "has demonstrated a willingness and ability to select competent class counsel and to negotiate a reasonable retainer agreement with that counsel"); Lowrey v. Toll Bros., No. 07-1513, 2007 U.S. Dist. LEXIS 99501, at *10 (E.D. Pa. June 29, 2007) (appointing lead plaintiff and expressing confidence that it "will endeavor to negotiate a reasonable fee arrangement with counsel"); *In re*

cases suggest that judges in other circuits rarely examine the fee agreements. Differences between judges and lead plaintiffs also remain unexplored. No one knows how often or to what extent judges overrule lead plaintiffs when awarding fees. Nor have the fee formulas used by judges and lead plaintiffs been compared. Although anecdotal reports suggest that judges find the "increase/decrease" approach more attractive than lead plaintiffs do, systematic evidence is lacking. We do not even know whether, on the whole, judges or institutional investors with large financial stakes tend to be more parsimonious with regard to attorneys' fees.

III. THE DATA ON EX ANTE AND EX POST FEE SETTING

A. The Sample

Using the Stanford Securities Class Action Clearinghouse, we identified 165 class actions that settled from January 1, 2007, through December 31, 2011,[62] in three federal district courts: the Central District of California (33), the Northern District of California (36), and the Southern District of New York (96). These three districts were chosen because they typically see the largest number of securities class action filings,[63] and we wanted to observe the behavior not only of law firms and lead plaintiffs but also of judges experienced in handling these matters. After obtaining docket sheets for all of these cases, we determined that a number had been transferred to other courts or otherwise dismissed, and we excluded these cases from the sample. Our final sample thus consisted of 134 cases. Table 1 presents summary statistics for the data set.

Able Labs. Sec. Litig., 425 F. Supp. 2d 562, 573–74 (D.N.J. 2006) (approving the lead plaintiff's choice for counsel when the plaintiff described the negotiated fee arrangement to the court).

62. These cases were filed between June 2000 and December 2010.

63. One recent survey found that the Second and Ninth Circuits have been the lead circuits for securities class action filings for every year since 1996. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2011 YEAR IN REVIEW 26 (2012), *available at* http://securities.stanford.edu/clearinghouse_research/2011_YIR/Cornerstone_Research_Filings_2011_YIR.pdf.

Table 1: Summary Statistics

	C.D. Cal.	N.D. Cal.	S.D.N.Y.	Total
Cases				
Settled 2007–2011	33	36	96	165
Excluded (Dismissed or Transferred)	1	0	30	30
Included in Analyses	32	36	66	134
Cases with Identified No. of Lead Plaintiffs				
1	22	18	36	76
2	5	7	12	24
3	2	8	10	20
4	2	1	6	9
5	1	1	2	4
6 or More	0	1	0	1
Lead Plaintiff Type				
Public Pension Fund	13	11	24	48
Other Institution	10	17	16	43
Individual	9	8	26	43
Total	32	36	66	134
Settlement Amounts ($000s, Constant 2012)				
Total	$1,451,669	$1,188,818	$3,187,276	$5,827,763
Mean	$43,491	$33,023	$48,292	$43,491
Median	$10,500	$9,576	$12,300	$11,000
25th Percentile	$4,820	$4,651	$3,455	$4,052
75th Percentile	$25,600	$19,300	$40,000	$31,000
Fee Requests (% of recovery)				
Mean	21.9%	24.3%	24.5%	23.8%
Median	25.0%	25.0%	25.0%	25.0%
25th Percentile	17.8%	22.5%	19.3%	20.0%
75th Percentile	25.0%	28.6%	30.0%	30.0%
Fee Awards (% of recovery)				
Mean	21.6%	22.6%	22.9%	22.5%
Median	25.0%	25.0%	25.0%	25.0%
25th Percentile	17.8%	20.0%	17.0%	18.0%
75th Percentile	25.0%	25.0%	30.0%	27.0%
Ratio of Fee Award to Fee Request				
Mean	0.993	0.943	0.933	0.950
Median	1.000	1.000	1.000	1.000
Cases with Fee Reductions	1	9	14	24
Cases with Identified No. of Objectors to Settlement				
0	24	28	51	103
1	8	3	7	18
2	0	0	2	2
3	0	1	3	4
4	0	1	0	1
5 or More	0	3	3	6
Cases with Fee Objections	5	8	12	25

For each case in our sample, we looked for evidence of ex ante fee negotiations between lead plaintiff candidates and the lawyers they retained. We also sought to learn whether judges considered evidence of fee negotiations when appointing lead plaintiffs, selecting class counsel, or awarding fees at the end of litigation. Specifically, we examined: (1) all motions for appointment of lead plaintiff and class counsel, along with all supporting memoranda and other documents; (2) court orders appointing lead plaintiffs and approving class counsel; (3) all motions, supporting memoranda, and other documents requesting an award of attorneys' fees; (4) any filed objections to the settlement, including to the proposed attorneys' fees; and (5) court orders granting final approval to the settlement and awarding attorneys' fees.

B. Empirical Findings

1. Evidence and Judicial Consideration of Ex Ante Fee Agreements

We found little evidence that ex ante fee agreements play a significant role in selecting the lead plaintiff. As we noted earlier, a handful of courts have held that evidence that a proposed lead plaintiff engaged in serious, arm's length negotiations with prospective counsel is relevant in determining whether the lead plaintiff candidate can adequately represent the class.[64] Those decisions, however, were few and far between in the reported cases, a pattern which was repeated in our sample. Discussions of fee arrangements were virtually nonexistent in our data set. Only 3 of the 134 orders appointing lead plaintiffs (2.24%) mentioned ex ante fee negotiations. No doubt the irrelevance of this factor in selecting the lead plaintiff derives from the PSLRA's statutory language, which makes the size of the lead plaintiff's financial stake in the litigation the overwhelming consideration.[65]

This statutory language may also help explain our similar finding regarding the frequency with which lead plaintiff candidates raised ex ante negotiations in their moving papers. In only 9.7% of cases did any lead plaintiff candidate mention such negotiations or

64. *See supra* notes 37–41 and accompanying text (discussing a Third Circuit case in which the Court stated that willingness "to select competent class counsel and to negotiate a reasonable retainer agreement with that counsel" could determine which lead plaintiff would "fairly and adequately represent[] the interests of the class").

65. *See supra* note 54 and accompanying text ("The key issue in applying the most adequate plaintiff presumption is determining which plaintiff has the largest financial interest in the relief sought by the class.").

any resulting fee agreement. Of course, simply because a set of moving papers is silent on fees is not definitive evidence that fee negotiations never occurred. Perhaps any agreement on fees was sufficiently vague that counsel did not think that referencing it would significantly enhance the argument in favor of the proposed lead plaintiff's adequacy. We also spoke to several plaintiffs' lawyers, and they universally expressed concern that disclosure to defendants of fee arrangements (particularly the fee breakpoints or tiers in the agreement) might disadvantage them in settlement negotiations.[66] Thus, even in cases in which a fee agreement has been negotiated ex ante and the lawyers would be permitted to submit their fee agreements to the court under seal, the fear of (inadvertent) disclosure may cause lawyers to shun public discussion of fee arrangements at the lead plaintiff appointment stage.

There is evidence that ex ante fee agreements play a greater, albeit still small, role at the fee award stage. In 17 of the 134 cases (12.7% of the sample), lead counsel argued that the presence of a negotiated ex ante fee agreement with the lead plaintiff justified its requested fee. Evidence in the record of an ex ante fee agreement is most prevalent when a public pension fund is the lead plaintiff.[67] Evidence of such an agreement was present in 18.75% of cases with public-pension lead plaintiffs compared to just over 9% of cases for both other institutional-investor lead plaintiffs and individual lead plaintiffs.[68]

66. Interviews with Anonymous Securities Class Action Lawyers (Jan. 21, 2013 and Nov. 16, 2012) (notes on file with authors). In conversations, several securities class action lawyers assured us that large institutional investors bargain over fees routinely. *Id.* They added that they and their clients prefer to keep the terms of fee agreements confidential, however. *Id.* In cases involving public pension funds, such agreements may nonetheless be a matter of public record due to state open records laws.

67. Our data is limited to the documents filed in the cases in our data set. It is possible that ex ante fee agreements existed in other of these cases but that the agreements were simply not referenced in any of the papers filed in the litigation. That raises the interesting question of why the lead plaintiff and/or its chosen counsel might prefer not to provide this information to the Court, a question that we take up in Part III.C below.

68. Due to the small sample size, these differences were insignificant at traditional levels.

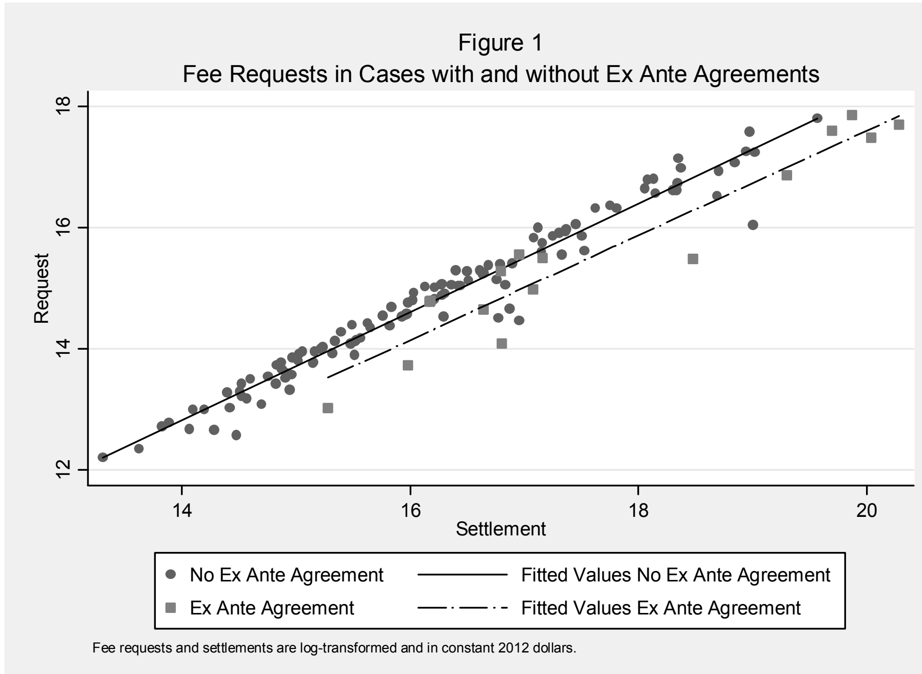


Figure 1 illustrates the relationship between fee requests and settlement size in cases with and without ex ante agreements. There are several important differences between the two subsamples. For cases without ex ante agreements, overall fee requests (measured as a percentage of the recovery) averaged 25.4%. Consistent with previous studies of fee awards in securities class actions, however, there is substantial variation with settlement size.[69] Measured as a percentage of recovery, fee requests decline as settlements increase. In the smallest quartile of settlements, fee requests in cases without ex ante agreements averaged 28.4%. Average requests in the next three quartiles, however, dropped to 27.5%, 24.1%, and 20.9%, respectively. The range of settlement sizes in cases without an ex ante agreement is also quite large. The smallest inflation-adjusted settlement was just $599,000; the largest was $314.7 million. With only a few exceptions, the fee requests in cases without ex ante agreements tend to be clustered along the upper frontier, (i.e., at the highest amount for any given settlement size).

69. *See, e.g.*, Perino, *supra* note 7, at 381 (finding that settlements were significantly larger in cases with public pension lead plaintiffs than in those with non-institutional lead plaintiffs).

By contrast, fee requests in cases with ex ante agreements averaged just 13.2%, a difference that is significant at less than 0.1%. While average requests in ex ante cases are smaller than in cases without such agreements, they too appear to decline as settlement size increases. In the second quartile of cases, fee requests averaged 14.2%. In the largest quartile they averaged 9.2%.[70] Unlike the requests in the subsample of cases without ex ante agreements, few of the cases with agreements are on the upper frontier. Most requests are well below the requests in the no-agreement cases at any given settlement size.

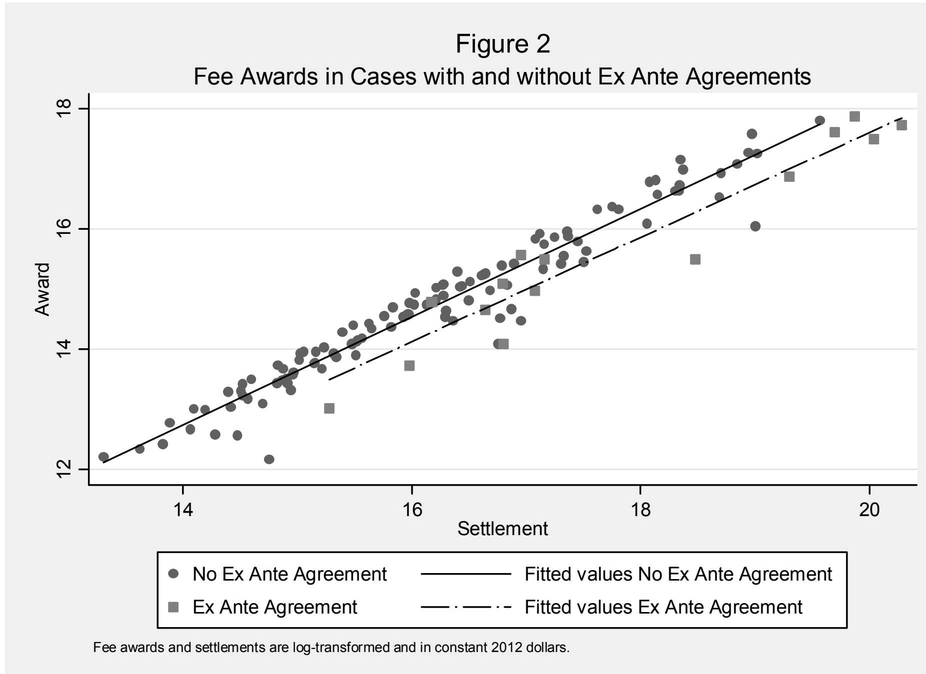
Settlements in cases with ex ante fee agreements are, on average, about three times larger than the settlements in cases without such agreements, with a range that is shifted considerably to the right.[71] The smallest inflation-adjusted settlement is $4.3 million (about seven times larger than the smallest settlement in the subsample of cases without such agreements). The largest is $641 million (twice as large as the largest settlement in the no-agreement subsample). The absence of smaller cases with ex ante agreements is actually even starker than these figures suggest because of the way we recorded settlement data. In cases with partial settlements, each settlement is a separate entry in our database. The smallest settlement with an ex ante fee agreement was a partial settlement in *In re Homestore.com, Inc. Securities Litigation*.[72] Aggregated together, however, the five *Homestore.com* settlements were just over $145.5 million, which hardly constitutes a small case. Besides these partial settlements, there are no cases with an ex ante fee agreement with a settlement below $10 million.

---

70. In the third quartile, fee requests actually increased to 16.4%, but this appears to be an anomaly from our small sample of ex ante cases.

71. The average settlement in cases without ex ante fee agreements was $28.9 million, compared to an average of $144 million in the cases with such agreements. This difference is significant at less than 0.1%.

72. *See* Declaration of Nancy L. Fineman in Support of Lead Plaintiff's Motion for: (1) Final Approval of Class Settlement with Cendant and Richard A. Smith; (2) Approval of Plan of Allocation; (3) Approval of Award of Attorneys' Fees and Reimbursement of Expenses; (4) Approval to Distribute Claims Administration Funds; and (5) Approval of Timing of Distribution at 1, 6, *In re* Homestore.com, Inc. Sec. Litig., No. 01-CV-11115 (C.D. Cal.) (Declaration filed Feb. 29, 2009; case filed Dec. 27, 2001) (referencing ex ante fee agreement). This partial settlement was for $4 million. *Id.* at 4.



We see the same pattern when we look at fee awards (Figure 2). Average fee awards in cases without ex ante agreements were 23.9% but dropped as settlement size increased. In cases with ex ante agreements, fee awards were significantly lower (13.0%) and declined over the range of settlements.[73] The distributions were also substantially similar. Fee awards in cases without evidence of agreements were, for the most part, clustered on the upper frontier while awards in cases with agreements tended to be substantially lower at equivalent settlement sizes.

There is some evidence that courts showed greater deference to fee requests that are the product of an ex ante agreement. To make this determination, we calculated the ratio of the fee award to the fee request. For cases without an ex ante agreement, courts awarded on average 94.4% of the fees the lead counsel requested, compared to 99.1% in cases with an ex ante agreement.[74] Judges cut the fee request in only 1 of 17 cases with ex ante agreements (5.9%) compared to 23 of 117 cases without such agreements (19.7%). Given the small number

73. The difference in means was significant at less than 0.1%.

74. A one-tailed test showed that this difference in means was significant at the 10% level (probability = 0.084).

of cases with ex ante agreements, this difference in the frequency of fee cuts is not statistically significant.[75]

Even absent evidence of an ex ante agreement, courts seem to defer to the fees proposed in cases with obviously sophisticated lead plaintiffs. In cases with public pensions as lead plaintiffs, courts cut fees only 6.3% of the time, significantly less frequently than in cases with other kinds of institutional lead plaintiffs (23.3%) or in cases with individuals as the lead plaintiffs (25.6%).[76] The ratio of award to request was significantly higher in the public pension fund cases (99.0%) than in the cases with individual lead plaintiffs (92.8%).[77] Because public pension funds are the most likely to have ex ante fee arrangements,[78] these results provide indirect evidence that courts defer to negotiated fee agreements in securities class actions.

While these are just summary statistics and thus do not control for, among other things, settlement size or the greater percentage of public pension funds in cases with ex ante fee agreements,[79] they do raise some intriguing possibilities. Courts awarding fees in class actions have frequently expressed concern that their fee awards are inherently imprecise because they do not know what fee arrangements sophisticated plaintiffs would reach if they were able to engage in arm's length negotiations with class counsel. Given the small sample we have been able to obtain, we need to interpret these data with caution. Nonetheless, it appears that the concerns courts have expressed were well founded—fees that are the product of ex ante agreements appear to be sharply lower than the fees courts award in securities-fraud class actions without such agreements.

To further test these relationships, we ran regressions with the fee request and the fee award as dependent variables (Table 2). In addition to an indicator variable for the presence of an ex ante fee

75. A chi-square test yielded a probability of 0.166.

76. These differences are significant at less than 5% (chi square = 6.995, probability = 0.03). The other institutions that we coded for in the data set were union-affiliated funds and private institutions.

77. In a comparison between public pension funds and all other lead plaintiffs, the difference in ratio of award to request was significant (probability = 0.007). We compared mean ratios for cases led by public pension funds, other institutional investors, and individuals. While the ratio was lower for other institutions (95.2%), only the difference between public pension funds and individuals was significant (probability = 0.004).

78. *See* Interviews with Anonymous Securities Class Action Lawyers, *supra* note 66 (noting that as public entities, these funds are subject to various requirements of state law in order to retain and pay outside counsel).

79. Perino, *supra* note 7, at 369 (finding that, all thing being equal, cases with public pension lead plaintiffs had significantly lower fee requests and awards than cases with other lead plaintiff types).

agreement,[80] the independent variables include five case characteristics that prior studies have shown are correlated with fee requests and awards: (1) the inflation-adjusted settlement amount; (2) the age of the case; (3) the presence of a public pension fund or other institutional investor as lead plaintiff; (4) the presence of certain law firms; and (5) the district in which the case was litigated. To simplify interpretation of the regression coefficients, we report fee requests and fee awards as a percentage of the settlement amount.[81]

80. We coded cases as 1 if the motion for a fee award referenced an ex ante fee agreement and 0 otherwise. Our measure may thus be biased to the extent that the case involved such an agreement but the moving papers did not discuss it.

81. We reran the regressions using log-transformed fee requests and fee awards reported in constant 2012 dollars. There was no change in the significance of the variables of interest. Some prior studies on attorneys' fees in class actions transformed these proportions using either square roots or log odds. *See* Choi et al., *supra* note 7, at 895; Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 61–62 (2004). As a robustness check, we reran all the regressions using both transformations. Again, there was no change in the significance of the relevant variables.

Table 2: Regressions for Fee Request and Fee Award[82]

	(Model 1) **Request**	(Model 2) **Request**	(Model 3) **Award**	(Model 4) **Award**
Settlement	-0.013***		-0.013***	
	(0.003)		(0.004)	
Mean Settlement		-0.013***		-0.013***
		(0.003)		(0.004)
Age	-0.003	-0.003	-0.001	-0.001
	(0.003)	(0.003)	(0.003)	(0.003)
Public Pension	-0.069***	-0.069***	-0.065***	-0.065***
	(0.012)	(0.012)	(0.014)	(0.014)
Other Institution	-0.012	-0.012	-0.013	-0.013
	(0.010)	(0.010)	(0.012)	(0.012)
Ex Ante Agreement	-0.089***	-0.089***	-0.091***	-0.091***
	(0.018)	(0.018)	(0.020)	(0.020)
Bernstein Litowitz	0.007	0.007	0.003	0.003
	(0.016)	(0.016)	(0.016)	(0.016)
Milberg & Successors	0.004	0.004	-0.007	-0.007
	(0.010)	(0.010)	(0.011)	(0.011)
N.D. Cal.	-0.004	-0.004	-0.003	-0.003
	(0.011)	(0.011)	(0.012)	(0.012)
S.D.N.Y.	0.008	0.008	0.007	0.007
	(0.011)	(0.011)	(0.011)	(0.011)
Fee Cut			-0.063***	-0.063***
			(0.014)	(0.014)
Constant	0.501***	0.285***	0.491***	0.277***
	(0.053)	(0.015)	(0.059)	(0.016)
Observations	133	133	133	133
R-squared	0.630	0.630	0.563	0.563

82. *** p<0.01, ** p<0.05, * p<0.1. Robust standard errors are reported in parentheses. Settlement is log-transformed and in constant 2012 dollars. Sources: Stanford Law School, *Securities Class Action Clearinghouse,* Bloomberg, PACER.

Model 1 in Table 2 shows that, even when controlling for these variables, the presence of an ex ante fee agreement is negative and significant, both statistically and economically. To give a clear sense of the magnitude of these effects, Model 2 centers the regression at the mean settlement size in the database ($43.5 million). In such a case, average fee requests in cases without an ex ante agreement were 28.5% (or $12.4 million). By contrast, mean fee requests in cases with a fee agreement were 19.6% (or $8.5 million), a 31% reduction in the fee requested.

Consistent with prior studies, we find the presence of a public pension lead plaintiff is correlated with significantly lower fee requests. On average, cases with public pension lead plaintiffs have fee requests that are 6.9% lower than cases with other lead plaintiff types, a reduction of $3.0 million at the mean settlement amount. There are, in addition, two other notable findings in Models 1 and 2. First, other institutions (which are defined to include union-affiliated funds and private institutions) have no significant impact on fee requests. Their fee requests are, in other words, statistically indistinguishable from the reference category of individual lead plaintiffs. Second, the size of the ex ante effect is roughly similar to the public pension effect. At mean settlement values, cases with public pension funds as the lead plaintiff have average fee requests of 21.6% compared to 19.6% in cases with ex ante agreements.

It is important to emphasize that the variables *Ex Ante* and *Public Pension* are not necessarily measuring separate effects. About 19% of the cases with public pension lead plaintiffs in our sample had evidence of an ex ante agreement, compared to 9.3% of the cases with other kinds of lead plaintiffs. Our informal interviews with plaintiffs' attorneys revealed that, in their experience, some form of ex ante agreement is present in virtually all cases with public pension lead plaintiffs. These two variables are therefore likely measuring some variation of the same thing—the impact that a sophisticated and engaged lead plaintiff has on fee requests.

Models 3 and 4 repeat these regressions with the fee award as the dependent variable. The only other difference in these models is that we have added an indicator variable (*Fee Cut*), which takes a value of 1 if the court cut the requested fee and 0 otherwise. Including this variable allows us to assess the comparative effects on fee awards of public pension funds, ex ante agreements, and judges.

The variable *Ex Ante* is negative and significant in the models for fee awards. At the mean settlement size, the average fee award in a case without an ex ante agreement was 27.7% ($12.049 million) compared to 18.6% ($8.091 million) in a case with such an agreement.

As in the models for fee requests, the public-pension variable remains statistically significant in the models for fee awards.[83] At mean settlement values, the average public-pension case has a fee award of 21.2%. These reductions in average fee awards suggest that substantial economic benefits might accrue if courts were to insist on ex ante bargaining over fees between the lead plaintiff and its chosen counsel.

Perhaps the most notable feature of the fee-award models is the result for the variable *Fee Cut*. It is hardly surprising that this variable is negative and significant. What is somewhat surprising is the average size of the effect. All else being equal, when a court cuts fees, the award is 6.3% lower. In other words, at mean settlement values, average fees drop from 27.7% to 21.4%. The magnitude of this effect is thus nearly identical to the magnitude of the *Public Pension* and *Ex Ante* effects. The key difference, of course, is *when* in the case they occur. Public pension fund bargaining and ex ante fee agreements occur when the case commences, which permits the lawyers some fair degree of certainty about the fee that they will obtain and promotes an efficient level of investment in the case. In contrast, predicting when or if courts will cut fees is much more difficult, as we discuss in more detail below.

2. Judicial Reductions of Requested Fees

In 24 of the 134 cases studied (17.9%), the court awarded a smaller fee than lead counsel requested.[84] This result is striking, given

83. Other institutional investors again have no statistically significant correlation with fee awards as compared to the reference group of individual investors.

84. There were two other cases that arguably involved fee reductions but which we decided not to count as "fee cut" cases for purposes of our analysis. In one case, *In re FuWei Films Securities Litigation*, class counsel requested a fee of one-third of the gross settlement fund. *See* Memorandum of Law in Support of Lead Plaintiff's Motion For: (1) Final Approval of Proposed Class Action Settlement; and (2) Award of Counsel Fees and Reimbursement of Expenses at 2, *In re* FuWei Films Sec. Litig., No., 07-CV-9416 (S.D.N.Y.) (Memorandum filed March 28, 2011; case filed October 19, 2007) [hereinafter *FuWei Films*]. The Court stated in its order that it was granting the fee request but then ordered a fee of 33.0% rather than 33.33%. Order Awarding Lead Plaintiff's Counsel Attorneys' Fees and Reimbursement of Expenses at 1, *FuWei Films* (Order filed April 27, 2011). In the other case, *In re Giant Interactive Group, Inc. Securities Litigation*, class counsel initially requested a fee of 33.0% of the *gross* settlement fund. *See* Lead Plaintiffs' Counsel's Memorandum of Law in Support of Motion for an Award of Attorneys' Fees and Expenses and Plaintiff Awards at 1, *In re* Giant Interactive, No. 07-CV-10588 (PAE) (S.D.N.Y.) (Memorandum filed Oct. 5, 2011; case filed Nov. 26, 2007) [hereinafter *Giant Interactive Group*]. In awarding the attorneys 33.0% of the *net* settlement fund, the Court stated in its order that although the attorneys' had originally requested a fee of 33.0% of the *gross* settlement fund, they had revised their request to 33.0% of the *net* settlement fund after the

that the fees requested were implicitly, if not always explicitly, agreed to by the lead plaintiff who, by definition, is the "most adequate plaintiff" with the largest financial stake in the litigation. Moreover, in only 2 of the 24 cases did an objector formally challenge the size of the requested fee.[85] Thus, in 91.7% of the cases in which the court cut the requested attorneys' fees, the court did so sua sponte, without the lead plaintiff or any other class member questioning the size of the fee request.

The requested fees in these 24 cases ranged from 19.25%[86] to 33.33%,[87] with the fee awards ranging from 7.0%[88] to 30.0%.[89] The

---

Court explained to them that it prefers to award fees as a percentage of the net, rather than gross, settlement fund. *See* Memorandum & Order at 15 & n.4, *Giant Interactive Group* (Memorandum & Order filed Nov. 2, 2011). Because the attorneys could have requested a net amount that was equivalent to 33.0% of the gross, but instead chose simply to request 33.0% of the net, we considered that their sincere request. The court did grant that request. *Id.* at 18.

The 24 cases in our data set that we determined involved fee awards by the court that were lower than the requests made by class counsel are listed in an appendix to this article.

One of these 24 cases arguably included two fee cuts. In *In re Chiron Corporation Securities Litigation*, the Court noted in its Order of January 6, 2009 awarding attorneys' fees that it had originally (on Nov. 30, 2007) denied preliminary approval of a proposed settlement in the case because of four concerns including that "the settlement awarded class counsel fees that were eight to ten times typical fees." Order at 1, *In re* Chiron Corp. Sec. Litig., No. C-04-4293 VRW (N.D. Cal.) (Order filed Jan. 6, 2009; case filed Oct. 12, 2004) [hereinafter *Chiron*]. The Court noted that class counsel subsequently "reduced the amount of their fee request, from 25% to 17% of the [$30 million] settlement." *Id.* at 2. The Court granted preliminary approval in June 2008. *Id.* In granting final approval to the settlement pursuant to a hearing on December 3, 2008, however, the Court performed a lodestar cross-check and further reduced class counsel's fee award to $4.6 million (15.33%) of the $30 million settlement. *Id.* The primary concern expressed by the Court when imposing the further fee cut was that the fee request "implied a multiplier in the range of 4.07-5.15" which the Court believed "exceed levels courts have accepted as reasonable fees." *Id.* The fee award of 15.33%, in contrast, "implies a multiplier of 3.67-4.64" which the Court stated "is still a generous multiplier, [but] it more accurately represents the risk faced by class counsel and brings the award within the standard range of multipliers." *Id.* at 26. For purposes of our analyses, we viewed the original request of a 25% fee, rather than the revised request of 17%, as the fee request against which we compared the Court's eventual award of a 15.3% fee.

85. *See* Order Awarding Attorneys' Fees at 5 & n.2, *In re* Nuvelo, Inc. Sec. Litig., No. C 07-04056 (CRB) (N.D. Cal.) (Order filed July 6, 2011; case filed Aug. 8, 2007) [hereinafter *Nuvelo*] (noting that "[o]nly one class member has objected to the 30% [proposed fee] award, which objection counsel have addressed"); Order, *Chiron*, *supra* note 84, at 9–10 (noting that seven class members "raised concerns about the proposed settlement" via email including "concern about high class counsel fees, although none provided detailed explanations of his or her concerns").

86. Memorandum of Law in Support of Plaintiffs' Counsel's Petition for an Award of Attorneys' Fees and Reimbursement of Expenses at 2, *In re* Lehman Bros. Sec. & ERISA Litig., No. 09-MD-2017 (LAK) (S.D.N.Y.) (Memorandum filed May 31, 2012; case filed July 29, 2008) [hereinafter *Lehman*].

87. Memorandum of Points and Authorities in Support of an Award of Attorneys' Fees, Awards to Lead Plaintiffs, and Reimbursement of Expenses at 1, Ansell v. Laikin, No. CV-10-09292-PA (AGRx) (C.D. Cal.) (Memorandum filed May 21, 2012; case filed Dec. 3, 2010)

ratio of award to request in these cases ranged from 0.25 to 0.93; the largest reduction was 30.0% to 7.6%,[90] and the two smallest reductions were 27.0% to 25.0%[91] and 32.4% to 30.0%.[92] In the two cases in which an objector challenged the requested fee, the ratio of award to request was 0.93 (28.0% to 30.0%),[93] and 0.61 (0.25% to 15.3%).[94]

The lead plaintiffs in the 24 cases with fee reductions were disproportionately individuals (41.7%), notwithstanding the fact that

---

[hereinafter *National Lampoon*]; Notice of Motion and Motion of Lead Plaintiff for an Order Awarding Attorneys' Fees and Reimbursement of Expenses; Memorandum of Points and Authorities in Support Thereof at 2, Rudolph v. UTStarcom, No. 3:07-CV-04578-SI (N.D. Cal.) (Notice of Motion filed Aug. 7, 2009; case filed Sept. 4, 2007) [hereinafter *UTStarcom*]; [Corrected] Notice of Motion and Memorandum of Points and Authorities in Support of Motion for Final Approval of Settlement and Award of Attorneys' Fees and Expenses at 1, 15, Mongeli v. Terayon Commc'ns Sys., Inc., No. 4:06-cv-03936-CW (N.D. Cal.) (Notice of Motion filed Sept. 4, 2008; case filed June 23, 2006) [hereinafter *Terayon*]; Notice of Motion and Motion for Award of Attorneys' Fees and Reimbursement of Costs and Memorandum of Points and Authorities in Support at 2, *In re* ShoreTel, Inc. Sec. Litig., No. C-08-00271-CRB (N.D. Cal.) (Notice of Motion filed Sept. 10, 2010; case filed Jan. 15, 2008) [hereinafter *ShoreTel*].

88. Judgment and Order of Dismissal with Prejudice at 11, Lifschitz v. Hexion Specialty Chems., Inc., No. 08-CV-6394 (RMB) (S.D.N.Y.) (Judgment filed May 19, 2010; case filed July 17, 2008) [hereinafter *Hexion*].

89. Memorandum Opinion and Order at 9, *In re* Sadia S.A. Sec. Litig., No. 08-CV-9528 (SAS) (S.D.N.Y.) (Memorandum Opinion filed Dec. 28, 2011; case filed Nov. 5, 2008) [hereinafter *Sadia*].

90. Lead Counsel's Memorandum of Law in Support of Motion for an Award of Attorneys' Fees and Expenses at 1, Kleiman v. RHI Entm't, Inc., No. 1:09-cv-08634-AKH (S.D.N.Y.) (Memorandum filed Oct. 4, 2011; case filed Oct. 9, 2009) [hereinafter *RHI*] (requesting fees of 30% of $2.5 million settlement ($750,000)); Order Awarding Attorneys' Fees and Expenses at 1, *RHI* (Order filed Nov. 22, 2011) (ordering fees of 7.6% ($190,000)).

91. Class Counsel's Notice of Motion and Memorandum of Points and Authorities in Support of an Award of Attorney Fees and Expenses at 1, *In re* Harmonic Inc. Sec. Litig., No. C-00-2287-PJH (EMC) (N.D. Cal.) (Notice of Motion filed June 2, 2008; case filed June 28, 2000) [hereinafter *Harmonic*] (requesting fees of 27% of $15 million settlement); Order Awarding Class Counsel Attorney Fees and Expenses at 1, *Harmonic* (filed Oct. 29, 2008) (ordering fees of 25%).

92. Memorandum of Law in Support of Class Counsels' Application for an Award of Attorneys' Fees and Expenses and An Award of Costs and Expenses to the Class Representatives at 1, *Sadia*, *supra* note 89 (filed Nov. 27, 2011) (requesting fees of 33.33% of net settlement of $26,276,771.64 ($27 million minus expenses of $723,228.36), which is 32.4% of gross settlement of $27 million); Memorandum Opinion and Order at 9, *Sadia*, *supra* note 89 (awarding 30% of gross settlement of $27 million).

93. Order Awarding Attorneys' Fees at 1, *Nuvelo*, *supra* note 85 (awarding fees of 30% of the net settlement fund, which was 28% of the gross settlement fund); Plaintiffs' Notice of Motion and Motion for Award of Attorneys' Fees and Expenses and Awards to Settlement Class Representatives; Memorandum of Points and Authorities in Support of Motion at viii, 2, *Nuvelo*, *supra* note 85 (filed May 6, 2011) (requesting fees of 30% of the gross settlement fund)).

94. Order at 2, *Chiron*, *supra* note 84 (awarding fees of $4.6 million, which was 15.33% of the $30 million gross settlement); Memorandum of Points and Authorities in Support of Motion for Preliminary Approval of the Proposed Settlement, the Proposed Plan of Allocation, and Attorneys' Fees and Reimbursement of Expenses at 18, *Chiron*, *supra* note 84 (filed May 4, 2007) (requesting fees of 25% of the gross settlement fund).

individuals were the lead plaintiffs in only 31.9% of the cases in the larger data set. The other lead plaintiffs in these fee-cut cases were union funds (33.3%), public pension funds (12.5%), and private institutions (12.5%). Cases with public pension funds were significantly less likely to have fee cuts than cases with other kinds of lead plaintiffs.[95]

In 29.2% of the fee-reduction cases, the court gave no reason or justification at all for its decision to award a smaller fee than that requested.[96] In each of the other 17 cases, the court gave various, often multiple, reasons for the fee reduction, which are summarized in Table 3 and detailed in the Appendix. Notably, in none of the cases did

Table 3: Judicial Rationales for Fee Cuts

Rationale	Frequency
The requested fee is "too large"	13
The requested fee is "too large given the work performed by the attorneys"	14
The requested fee is "too large given lead counsel's actual risk of nonrecovery"	13
The requested fee is "out of line with fees in similar cases"	9
The requested fee fails a lodestar cross-check	7
The court cannot rely on the market for setting attorneys' fees	1

the court offer as a reason for cutting fees that the lead plaintiff and lead counsel had not bargained at arm's length.[97]

95. Chi-square = 6.917; probability = 0.009.

96. *See* Order Awarding Attorneys' Fees and Expenses (filed Nov. 22, 2011), *RHI*, *supra* note 90; Order Awarding Attorneys' Fees, *Nuvelo*, *supra* note 85; Order Approving Award of Attorneys' Fees and Expenses and Plan of Allocation, *Terayon*, *supra* note 87; Order and Final Judgment, Ladmen Partners, Inc. v. Globalstar, Inc., No. 07-CV-0976 (S.D.N.Y.) (Order filed Feb. 22, 2010; case filed Feb. 9, 2007) [hereinafter *Globalstar*]; Order Awarding Class Counsel Attorney Fees and Expenses, *Harmonic*, *supra* note 91 (Order filed Oct. 29, 2008); Order re: Award of Fees to Plaintiff's Counsel; Reimbursement of Expenses, *In re* TVIA, Inc. Sec. Litig., No. C-06-06304 RMW (N.D. Cal.) (Order filed July 7, 2008; case filed Oct. 6, 2006) [hereinafter *TVIA*]; Order of Final Judgment, *In re* SLM Corp. Sec. Litig., 08-CV-1029 (WHP) (S.D.N.Y.) (Order filed Sept. 6, 2012; case filed Jan. 31, 2008) [hereinafter *SLM*].

97. It merits note, however, that in *In re Chiron Corporation Securities Litigation*, the Court's order of January 6, 2009, awarding attorneys' fees included discussion of the factors that prevented the court from granting preliminary settlement approval in November 2007. The Court noted that it

> was concerned that the lead plaintiff, International Union of Operating Engineers Local 825, would not fairly and adequately represent all class members because of its relationship with class counsel and its involvement as lead counsel in other securities class action lawsuits. . . . These concerns were resolved when the court certified Local 825 as lead counsel [sic] on June 18, 2008 . . . .

Order, *Chiron*, *supra* note 84, at 27.

The seven cases (two from the Southern District of New York and five from the Northern District of California) in which the court gave no reason for cutting the requested fee involved seven different judges, three of whom were involved in multiple cases involving fee reductions (Hellerstein, two cases; Breyer, three cases; Pauley, two cases). Each of these judges, however, gave reasons for reducing fees in their other cases. Among the seven cases in which no justification for the fee cut was given, four cases had a ratio of award to request of 0.90 or greater, indicating a relatively small fee cut.[98] The other three cases, however, included the case with the largest fee cut (0.25 ratio of award to request).[99] In three of these seven cases, the lead plaintiff was an individual, while the others were private institutions (two), union funds (one), and a public pension fund (one).

---

98. *Compare* Order Awarding Attorneys' Fees at 10–11 (filed July 6, 2011) (awarding fees of 28% of the gross settlement fund), *Nuvelo*, *supra* note 85, *with* Plaintiffs' Notice of Motion and Motion for Award of Attorneys' Fees and Expenses and Awards to Settlement Class Representatives; Memorandum of Points and Authorities in Support of Motion at viii (filed May 6, 2011) (requesting fess of 30% of the gross settlement fund), *Nuvelo*, *supra* note 85, resulting in a ratio of 0.93. *Compare* Order and Final Judgment at 5 (filed Feb. 22, 2010) (awarding fees of 18.33% of the gross settlement fund ($275,000 of a $1.5 million gross fund)), *Globalstar*, *supra* note 96, *with* Lead Plaintiff's Memorandum of Law in Support of An Award of Attorneys' Fees and Reimbursement of Expenses at 1 (filed Feb. 4, 2010) (requesting fees of 20% of the gross settlement), *Globalstar*, *supra* note 96, resulting in a ratio of 0.92. *Compare* Order Awarding Class Counsel Attorney Fees and Expenses at 1 (filed Oct. 29, 2008) (awarding fees of 25% of the gross settlement fund), *Harmonic*, *supra* note 91, *with* Class Counsel's Notice of Motion and Memorandum of Points and Authorities in Support of an Award of Attorney Fees and Expenses at 1 (filed June 2, 2008) (requesting fees of 27% of the gross settlement fund), *Harmonic*, *supra* note 91, resulting in a ratio of 0.93. *Compare* Order of Final Judgment at 5 (filed Sept. 6, 2012) (awarding fees of 22.5% of the gross settlement fund ($7.875 million of a $35 million gross fund)), *SLM*, *supra* note 96, *with* Memorandum of Law in Support of Lead Plaintiff SLM Ventures' Motion for Award of Attorneys' Fees and Reimbursement of Litigation Expenses at 1 (filed May 28, 2012) (requesting fees of 25% of the gross settlement fund), *SLM*, *supra* note 96, resulting in a ratio of 0.90.

99. *Compare* Order Awarding Attorneys' Fees and Expenses at 1 (filed Nov. 22, 2011) (awarding 7.6% of the gross settlement fund ($190,000 on a gross settlement of $2.5 million)), *RHI*, *supra* note 90, *with* Lead Counsel's Memorandum of Law in Support of Motion for an Award of Attorneys' Fees and Expenses at 1 (filed Oct. 4, 2011) (requesting fees of 30% of the gross settlement fund), *RHI*, *supra* note 90, resulting in a ratio of 0.25. *Compare* Order Approving Award of Attorneys' Fees and Expenses and Plan of Allocation at 2 (filed Sept. 23, 2008) (awarding fees of 25% of the gross settlement), *Terayon*, *supra* note 87, *with* [Corrected] Notice of Motion and Memorandum of Points and Authorities in Support of Motion for Final Approval of Settlement and Award of Attorneys' Fees and Expenses at 1 (filed Sept. 4, 2008) (requesting fees of 33-1/3% of the gross settlement fund), *Terayon*, *supra* note 87, resulting in a ratio of 0.75. *Compare* Order re: Award of Fees to Plaintiff's Counsel; Reimbursement of Expenses at 2 (filed July 7, 2008) (awarding fees of 22.8% of the gross settlement fund ($650,000 of a gross fund of $2.85 million)), *TVIA*, *supra* note 96, *with* Notice of Motion and Memorandum of Points and Authorities in Support of Lead Plaintiff's Motion for Attorneys' Fees and Expenses and an Award to Lead Plaintiff at 2 (filed Jan. 4, 2008) (requesting fees of 27.2% of the gross settlement fund), *TVIA*, *supra* note 96, resulting in a ratio of 0.84.

As noted in the Section above, courts showed greater deference to fee requests that were the product of ex ante agreements. For cases without an ex ante agreement, courts awarded on average 94% of the fees the lead counsel requested, compared to 99% in cases with an ex ante agreement.[100] Judges cut the fee request in only 1 of 17 cases with ex ante agreements (5.9%), compared to 23 of 117 cases without such agreements (19.7%).

In the lone case (*In re Escala Securities Litigation*) in which the court cut the requested fees notwithstanding the existence of an ex ante fee agreement, the court made no reference to the agreement in its fee order.[101] Nor did the court explain why it awarded less than the requested fee notwithstanding the fact that the reduction was relatively large (0.82 ratio of award to request). The blame for this jurisprudential lapse cannot entirely be placed on the court, however, since its fee order was simply the order proposed by lead counsel with the fee award amount written in (and the word "proposed" in the title of the order crossed out). As drafted by lead counsel, the two-page order did give the following list of factors in support of the fee amount, none of which the court crossed out or otherwise altered:

> The court finds such an award to be fair and reasonable under the circumstances of this case, in light of, among others, the following factors:
>
> •the time and labor expended by counsel;
> •the magnitude and complexities of the litigation;
> •the risk of the litigation;
> •the quality of the representation; and
> •the requested fee in relation to the settlement.[102]

One is left to infer that the court, upon consideration of these factors, simply came to a different determination than the lead plaintiff and its chosen counsel regarding the value of the attorneys' services, notwithstanding the existence of an ex ante fee agreement between the sophisticated lead plaintiff (a public pension fund) and its counsel and the absence of any indication that the lead plaintiff now regretted having entered into that contract or any filed objection to the requested fee.

100. A one-tailed test showed that this difference in means was significant at the 10% level (probability = 0.084).

101. Order Granting Application for an Award of Attorneys' Fees and Reimbursement of Expenses, *In re* Escala Grp., Inc. Sec. Litig., 06-cv-3518 (AKH) (S.D.N.Y) (Order filed Dec. 3, 2008; case filed May 9, 2006) [hereinafter *Escala Group*].

102. *Id.* at 1.

C. What Explains These Empirical Findings?

Our empirical findings raise at least two broad categories of questions: Why are there so few reported instances of ex ante fee agreements between the lead plaintiff and its chosen counsel? And why are courts so frequently cutting the fees requested by class counsel and approved by the lead plaintiff? In this Section, we take up each of these questions in turn.

With regard to the first question, it is important to note that our data can tell us only if the existence of an ex ante fee agreement was reported in the public filings in a case. In some cases, the lead plaintiff and its counsel may have entered into an ex ante fee agreement but never referenced that agreement in any of the motions, memoranda, or declarations/affidavits filed with the court. It is also possible, but much less likely, that in some cases an ex ante fee agreement was presented to the court ex parte and in camera and never noted on the docket sheet for the case. Thus, we must ask several different questions regarding these data.

If lead plaintiffs are in fact only rarely negotiating ex ante fee agreements with their chosen counsel, why are they not doing so more often? One possible answer is that courts have not required lead plaintiffs to provide evidence of such an agreement either when applying to be the lead plaintiff or in the context of reviewing the eventual request for attorneys' fees. But a lead plaintiff would presumably seek to negotiate such an agreement anyway if it thought there was an advantage in doing so. Perhaps the lead plaintiff believes that there is no reason to enter into an ex ante agreement regarding attorneys' fees because the fees will ultimately be set by the court at the end of the representation. But by contracting ex ante, the lead plaintiff would arguably be able to establish a firm cap on the fees that it (and the class) might be obligated by the court to pay.

Alternatively, perhaps the lead plaintiff is of the view that it will nonetheless be more advantageous to wait until the end of the representation to negotiate with class counsel regarding its fee. By waiting, the lead plaintiff will have more information regarding both the services provided by counsel and the terms of the proposed settlement. In addition, the lead plaintiff will have even more bargaining power at the end of litigation than at the outset, since class counsel, when making its fee request to the court, will need the support of the lead plaintiff (expressly or at least tacitly in the form of no explicit objection).

A final possibility is that many lead plaintiffs simply are not performing the function that Congress envisioned when it created the

PSLRA. Only 36% of the cases in our data set involved public pension funds as lead plaintiffs. The remainder had some combination of traditional individual plaintiffs or other kinds of institutional investors, such as union-affiliated funds. As our study and others have shown, only public pension funds are correlated with significantly lower fee requests and awards.[103] Thus, perhaps the remaining cases exhibit the same kind of lawyer domination that existed before the passage of the PSLRA. If the lead plaintiffs in these cases are indeed largely figureheads, then it is hardly surprising that they would not bargain hard with counsel to establish a fee arrangement at the start of the case.

This, of course, raises questions about why the lead plaintiff's chosen counsel would be willing to invest time and resources without any certainty regarding at least the minimum percentage fee that the lead plaintiff would support. Precisely because the support (or, at least, the non-objection) of the lead plaintiff will be needed at the time class counsel makes its fee request to the court, one might expect the counsel to want some firm assurances on this issue before investing in the case. Indeed, if a very aggressive lead plaintiff sought to impose a no-ex-ante-fee-agreement condition when selecting among possible candidates for class counsel, an experienced, high-quality law firm might prefer to just invest its time and resources in a different project. (Moreover, law firms might interpret such a condition on the counsel's employment as a signal that the lead plaintiff intends to support only an unusually low fee award at the end of the case.)

Another possibility is that class counsel is not keen to enter into a formal, written fee agreement ex ante, believing that such an agreement could only serve to limit an eventual fee request to the court. Counsel might also believe that any such agreement is immaterial, given that the final fee award is ultimately a decision for the court. Even so, such an agreement, if made known to the court, would seem likely to only help class counsel: it would frame the court's decision and arguably obligate the court to explain any decision to deviate downward from the ex ante agreement when reducing the fee. Moreover, if the court did award a fee lower than the one stipulated in the ex ante agreement, class counsel would seem to have a stronger case (or at least an additional set of arguments) if it chose to appeal the court's fee cut. In this context, the existence of an ex ante fee agreement would further mitigate any concern that class counsel was

103. *See* Perino, *supra* note 7, at 385, 389 (finding that public pension fund lead plaintiffs are correlated with significantly lower fee requests and awards).

acting adversely to the class in appealing a sua sponte fee cut by the court. Class counsel would simply be seeking enforcement of a valid contract with the lead plaintiff, a contract about which the lead plaintiff had expressed no concerns and to which (in the vast bulk of cases) no other class member had formally objected.

Of course, it is possible that a law firm would be better off without an ex ante agreement, particularly in cases without active public pension fund monitoring. Consider, for example, a case involving an average-sized settlement in which there is no public pension fund participation and no ex ante fee agreement. Our analysis shows that settlements in those cases have average fee awards of 27.7%.[104] The average fee cut is 6.3%, with cuts occurring in 17.9% of the cases. In cases with ex ante agreements, fee awards average 18.6%, and cuts occur in 5.9% of the cases. While having an ex ante agreement reduces the likelihood of a fee cut from about 1 in 5 to about 1 in 20, a simple expected return calculation shows that the lawyer is still better off without the ex ante agreement. The expected fee in a case without an agreement is 26.5% compared to 18.2% in cases with an agreement.[105] A rational, risk-neutral repeat player should thus prefer not to have an ex ante agreement precisely because it would substantially reduce fees (albeit to the benefit of the class), and the absence of such an agreement may therefore be evidence of a substantial agency cost problem.

As we noted previously, it is possible that ex ante fee agreements are negotiated between public pension lead plaintiffs and their chosen counsel in most cases but that class counsel simply prefers not to make the terms of the agreement public by filing it with the court. Class counsel might be concerned that revealing the terms of the fee agreement would provide the defendant information that it might be able to use against the class counsel in any eventual settlement negotiations (i.e., information identifying the breakpoints in an agreement that provided for different fee percentages depending on the size of the recovery). To the extent that class counsel is a repeat player in securities litigation, it might also be concerned that making

104. To be sure, we must use these figures with caution given our small sample size. Nonetheless, they are useful for illustrative purposes.

105. This analysis assumes that the average fee cut would occur in cases with and without an ex ante agreement. Recall, however, that we found that courts awarded on average 94% of the fees the lead counsel requested in cases in which an ex ante fee agreement was not a part of the record, compared to 99% in cases with an ex ante agreement. A more precise analysis would use the average fee cut in each subsample. Unfortunately, we have no way of reliably estimating those figures because our data set contains only one case in which there was both an ex ante agreement and a fee cut.

public the terms of its fee agreement in one case would restrict its ability to negotiate a different (more advantageous) fee arrangement with future clients. Relatedly, as a repeat player, counsel might be concerned about giving this fee information to its competitors, and about the effect the information could have on the larger market for plaintiffs' attorneys' fees in securities cases.

While courts permit fee agreements to be filed in camera and under seal, class counsel may be concerned that the information will ultimately become public if, for example, the court were to invoke the details of the information in its eventual fee order. Another possibility is that class counsel's estimates of the likelihood of fee cuts or the extent to which the court will defer to an ex ante agreement differ from the data we present here.[106] Relatedly, perhaps class counsel is

---

106. This view is not without basis in the sense that at least some courts have made clear that the existence of a fee agreement is not to be given any special deference, for example in terms of a presumption that the court would be obligated to rebut in awarding a lower fee. *See, e.g.*, Order, *Chiron*, *supra* note 84, at 11-12 (filed Jan. 6, 2009) (emphasis added):

> "Attorneys' fees provisions included in proposed class action settlement agreements are, like every other aspect of such agreements, subject to the determination whether the settlement is 'fundamentally fair, adequate, and reasonable.'" Staton v. Boeing Co., 327 F.3d 938, 963 (9th Cir. 2003), quoting FRCP 23(e). *The court is obligated to conduct an independent inquiry into the reasonableness of any attorney fee provisions of a class action settlement even in the face of an agreement between the parties regarding the payment and amount of attorney fees and costs*.
>
> Common fund cases create a situation in which normal reliance on the adversary process to police the appropriateness of a fee award is unavailing. Report of the Third Circuit Task Force, Court Awarded Attorney Fees (Task Force Report), 108 F.R.D. 237, 251 (3d Cir. 2985). . . . [A] class action defendant has little or no incentive to contest this amount allocated to attorney fees in a proposed settlement, provided the total amount of the settlement is acceptable. . . . *Task Force Report* at 266. "[T]o avoid abdicating its responsibility to review the agreement for the protection of the class, the Ninth Circuit requires that a district court must carefully assess the reasonableness of a fee amount spelled out in a class action settlement agreement." *Staton*, 327 F.3d at 963 . . . . This obligation is especially strong if the fee award appears high. *Staton*, 327 F.3d at 966.
>
> The court's obligation to ensure the fee award is reasonable exists in part because class members have little incentive to register complaints about the award. *In re* Cont'l Ill. Sec. Litig., 962 F.2d 566, 573 (7th Cir. 1992). While a substantial reduction in the amount class counsel receive as fees creates a larger pool for class members to share, an individual class member may see only a *de minimus* increase in his settlement value. *Id.* Individual class members may therefore lack the financial incentive to complain about an excessive fee award. But class members' silence does not lessen the court's responsibility to ensure that the fee award is fair and reasonable. Id.

See also Order, *In re* Chiron Corp. Sec. Litig., No. C-04-4293 VRW, 2007 WL 4249902, at *9 (N.D. Cal., Nov. 30, 2007):

> The court recognizes that the Seventh Circuit . . . takes a somewhat more prospective or ex ante approach [to assessing the reasonableness of class counsel fees]. See *In re* Synthroid Mktg. Litig., 264 F.3d 712 (7th Cir. 2001); where attorney fees are not determined up front in a case (and they usually are not), the Seventh Circuit instructs that the district court "undertake an analysis of the terms to which the

not inclined ever to appeal a court's fee award, no matter how large a deviation from the requested fee it represents, and thus is not concerned with any benefits on appeal of having provided the trial court information about the existence and terms of an ex ante fee agreement. For example, class counsel may fear that appealing a judicial fee cut will anger the current client and reduce its ability to secure future business.

Finally, it is possible that class counsel chooses not to provide information to the court about its ex ante fee agreements with the lead plaintiff because that agreement contains no more information than is already included in the notice to the class that was part of the preliminary approval process (e.g., "Class counsel will request as fees no more than xx% of the total gross settlement fund."). Or, more strategically, perhaps class counsel wants to preserve the option to negotiate more advantageous fee terms with the lead plaintiff at the end of the litigation, which might prove more awkward if the original fee agreement was provided to the court at the outset.

This brings us to the second question raised at the beginning of this Section: Why are courts so frequently cutting the fees requested by class counsel and approved by the lead plaintiff? As demonstrated above, in 91.7% of the cases in which the court cut the requested attorneys' fees, the court did so sua sponte, without the lead plaintiff or any other class member questioning the size of the fee request. Additionally, in 29.2% of the 24 cases with fee cuts, the court gave no reason at all for its decision.

One way to understand what judges might be thinking is to consider the 34-page order of Judge Vaughn Walker in *In re Chiron Corporation Securities Litigation*.[107] On the one hand, Judge Walker clearly put great time and effort into his decision on fees and devoted

private plaintiffs and their attorneys would have contracted at the outset of the litigation when the risk of loss still existed." *Sutton v. Bernard*, [504 F.3d 688 (7th Cir. 2007)].

Because a prospective fee negotiation occurs without the plaintiffs and the attorneys knowing what the recovery will be, if any, and how much of the attorney's time and expense will be needed to produce a recovery, the Seventh Circuit's approach is likely to take the form of a percentage approach. But this by no means suggests that a lodestar cross-check is inappropriate or unnecessary. Indeed, a lodestar cross-check is extremely useful in that context, because a reasonable percentage fee is not necessarily a flat or straight percentage. A prudent plaintiff negotiating in advance of litigation with contingent fee counsel should take account of the economies of scale inherent in large recoveries and require that counsel share those economies by demanding a sliding scale percentage. A lodestar cross-check can, therefore, assist a court attempting to find the reasonable percentage no less than the court attempting to find reasonable hourly compensation.

107. Order, *Chiron*, *supra* note 84 (filed Jan. 6, 2009).

many pages to discussing what hourly rates to use when calculating the lodestar, as well as how to determine the proper multiplier.[108] Indeed, with regard to the latter, the judge explicitly paid close attention to a 2003 study published in *Class Action Reports*, which set out the multipliers observed in 353 securities class actions with recoveries of $50 million or less (the recovery in *In re Chiron* was $30 million).[109] He ultimately determined that a reduction in the fee was required largely in order to bring the multiplier within the high end of the historical range for recoveries of comparable size.[110] In sum, Judge Walker did not simply decide that the requested fee was "just too large" and arbitrarily reduce it to an amount with which he was more viscerally comfortable.

At the same time, however, Judge Walker's analysis was premised on the assumption that the fee agreed to by the lead plaintiff (a union fund) and class counsel[111] should not be given any particular deference. It is possible that he concluded, without making this explicit, that the union fund was not monitoring class counsel as vigorously as the PLSRA intended, and in the absence of such oversight he needed to undertake de novo review. In any event, Judge Walker does not appear to have inquired whether the lead plaintiff and class counsel had entered into an ex ante fee agreement and, if so, what its terms were. And whatever the explanation, he does not recognize or acknowledge any distinction between his fee-setting role in a securities class action under the PSLRA and his fee-setting role in other types of class actions. In his view, because a court may not rely on the "normal . . . adversary process," it "is obligated to conduct an independent inquiry into the reasonableness of any attorney fee provisions of a class action settlement even in the face of an

108. *Id.* at 11–34.

109. *Id.* at 20–21.

110. *Id.* at 23–26.

111. We do not know if there was an ex ante fee agreement in this case; we do know that none was reported to exist in the record. In its fee request, however, class counsel did explicitly note that the requested fee was supported by the lead plaintiff. *See* Plaintiff's Notice of Motion and Motion in Support of Final Approval of Settlement, Plan of Allocation and Award of Attorneys' Fees and Expenses and in Reply to Comments and Objections from Class Members; Memorandum of Points and Authorities in Support Thereof at xii & 26 (filed Oct. 29, 2008) (noting that "*Lead Plaintiff* submits that the Court should . . . approve Class Counsel's request for Attorneys' Fees in the reduced amount of $5.1 million or just 17% of the Settlement Amount"; noting that "*Lead Plaintiff*[] . . . agreed to reduce the requested attorneys' fees to 17% from 25%") (emphasis added), *Chiron*, *supra* note 84; *see also* Lead Plaintiff's Response to Order of April 14, 2008 Re: Modified Terms of Settlement and Class Notice at 1 (filed April 18, 2008) (noting that "Lead Plaintiff and Lead Counsel will reduce the request for attorneys' fees to be described in the Class notice from 25% to 17%"), *Chiron*, *supra* note 84.

agreement between the parties regarding the payment and amount of attorney fees and costs."[112]

All but two of the authorities Judge Walker cites predate the enactment of the PSLRA. And neither of the two post-PSLRA cases is a securities class action.[113] Most ironically, the lone securities class action he cites (*Continental Illinois Securities Litigation*) to justify his judicial "obligation to ensure the fee award is reasonable,"[114] is a 1992 decision of the Seventh Circuit in which Judge Posner wrote the following for the panel:

> It is apparent what the district judge's mistake was. He thought he knew the value of the class lawyers' legal services better than the market did. What the market valued at $350 he thought worth only half as much. He may have been right in some ethical or philosophical sense of "value" but it is not the function of judges in fee litigation to determine the equivalent of the medieval just price. It is to determine what the lawyer would receive if he were selling his services in the market rather than being paid by court order.[115]
>
> . . . .
>
> The object in awarding a reasonable attorney's fee, as we have been at pains to stress, is to give the lawyer what he would have gotten in the way of a fee in an arm's length negotiation, had one been feasible. . . .[116]

So far as we know, Judge Walker never asked—either when appointing the lead plaintiff and approving its choice of counsel, or when awarding fees to the class counsel—whether the lead plaintiff and class counsel had undertaken arm's length negotiations at the outset of the litigation regarding attorneys' fees and, if so, what the terms of their ex ante agreement were.

D. Are Current Practices Desirable?

Our primary objectives in this study are descriptive. We want to know how fee award practices operate and whether ex ante fee

---

112. Order, *Chiron*, *supra* note 84, at 11.

113. *See id.* at 11–12 (citing Staton v. Boeing Co, 327 F.3d 938 (9th Cir. 2003)) (involving an award of attorneys' fees in an employment discrimination class action resolved through a consent decree); Strong v. BellSouth Telecomms. Inc., 137 F.3d 844 (5th Cir. 1998) (involving an award of attorneys' fees pursuant to the settlement of antitrust class actions brought by customers against their local telephone company in four states)).

114. Order, *Chiron*, *supra* note 84, at 12.

115. *In re* Cont'l Ill. Sec. Litig., 962 F.2d 566, 568 (7th Cir. 1992) (citing Missouri v. Jenkins, 491 U.S. 274, 285 (1989); Harsch v. Eisenberg, 956 F.2d 651, 663 (7th Cir. 1992); Bandura v. Orkin Exterminating Co., 865 F.2d 816, 822 (7th Cir. 1988); Tomazzoli v. Sheedy, 804 F.2d 93, 98 (7th Cir. 1986) (per curiam); Kirchoff v. Flynn, 786 F.2d 320, 323–26 (7th Cir. 1986); Henry v. Webermeier, 738 F.2d 188, 195 (1984)).

116. *Id.* at 572.

agreements influence them. Having learned that lead plaintiff candidates rarely bring ex ante agreements to judges' attention and that these agreements figure in ex post fee setting only slightly more often, we also have some normative concerns. In this Section, we will briefly consider the possibility that reforming the fee-setting process might help investors by making securities class actions more efficient.

The obvious reason for thinking that existing procedures are suboptimal is that they differ in a key respect from the practice prevailing in the market where sophisticated clients hire attorneys. Sophisticated clients typically set lawyers' fees when representations commence; judges set fees in securities class actions when lawsuits settle. Insofar as we know, ex ante bargaining occurs in all contexts in which sophisticated plaintiffs with large financial stakes hire attorneys,[117] including securities lawsuits brought on an individual (non-class) basis.[118] On the plausible assumption that sophisticated clients use efficient practices, one may reasonably hypothesize that ex post fee setting in class actions harms investors by creating deficient incentives.[119]

The superiority of ex ante fee setting likely reflects two considerations. First, it is reasonable to expect that lawyers will make better decisions throughout a litigation when fee terms are clear than when they can only guess what they will earn in the event of success. Fuzzy fee terms may discourage lawyers from taking desirable risks because they will lack confidence that their returns will exceed their costs. The known judicial tendency to reduce fee percentages as plaintiffs' recoveries rise probably strengthens this effect. Second, ex post fee setting bases lawyers' compensation on risk assessments that

---

117. *See, e.g.*, David L. Schwartz, *The Rise of Contingent Fee Representation in Patent Litigation*, 64 ALA. L. REV. 335, 360 (2012) (reporting that lawyers and clients always fix fee percentages and responsibility for expenses up front in patent representations); Stephen D. Susman, Fee Agreements in Technology Litigation: Harmonizing Client and Attorney Interests, presented at 20th Annual Technology and Computer Law Conference (May 23–25, 2007) (providing sample terms used in fee agreements in patent representations, including terms governing contingent percentages and responsibility for litigation expenses).

118. *See In re* Synthroid Mktg. Litig., 264 F.3d 712, 720–22 (7th Cir. 2001) (looking to securities "benchmarks for determining legal fees"); *see also* Kevin LaCroix, *Ohio Joins the Time Warner Opt-Out Settlement Parade*, D&O DIARY (2007), http://www.dandodiary.com/2007/03/articles/optouts/ohio-joins-the-time-warner-optout-settlement-parade/ (reporting that the State of Ohio agreed to pay "a 17.5% contingency fee to Lerach Coughlin" for representation in an opt-out securities case).

119. Professor Coffee contends that institutional investors that file individual lawsuits after opting out of a plaintiff class obtain larger recoveries because they can use fee agreements, including rising scales of percentages negotiated ex ante, to reduce agency costs. *See* John C. Coffee, Jr., *Accountability and Competition in Securities Class Actions: Why "Exit" Works Better Than "Voice*,*"* 30 CARDOZO L. REV. 407, 432 (2008).

are marred by hindsight bias. Judges who set fees ex post know how litigation risks played out, so they are likely to underestimate the magnitude of those risks considerably.[120] The primary object of percentage-based compensation is to encourage lawyers to accept desirable risks; thus it follows that ex post fee setting seems poorly designed for the task at hand.

By pointing out the deficiencies associated with ex post fee-setting arrangements, we join a group of commentators who believe that existing practices should be reformed.[121] Like these writers, we also have thoughts as to how an ex ante fee setting regime might work. We expect to develop our views on these subjects at greater length in subsequent work.

IV. CONCLUSION

We have used publicly available court documents to study the role that fee agreements play in the process of setting attorneys' fees in class actions brought under the PSLRA. Our work is preliminary, incomplete, and subject to important limitations. We focused on three federal district courts: the Central District of California, the Northern District of California, and the Southern District of New York. These courts are disproportionately important because they handle more securities-fraud class actions than others. But we cannot be confident that our findings are generalizable because other courts may have different practices. We studied only cases that closed between 2007 and 2011. Cases that closed in 2012 or that are currently ongoing may show that fee-setting practices have changed. Most importantly, we examined court filings, not actual fee agreements. Consequently, we can quantify the frequency with which judges knew about and considered ex ante fee agreements, but we cannot assess the rate at

---

120. *See* Chris Guthrie, Jeffrey J. Rachlinski & Andrew J. Wistrich, *Inside the Judicial Mind*, 86 CORNELL L. REV. 777, 799–805 (2001) (describing an experiment showing the impact of the hindsight bias on judges).

121. For criticisms of existing fee-setting arrangements, including proposals to set fees up front, see THIRD CIRCUIT TASK FORCE, SELECTION OF CLASS COUNSEL, 208 F.R.D. 340–427 (2002); THIRD CIRCUIT TASK FORCE, COURT AWARDED ATTORNEY FEES, 108 F.R.D. 255 (1986); MANUAL FOR COMPLEX LITIGATION (FOURTH) §§ 14.21, 14.211 (2004); ALAN HIRSCH & DIANE SHEEHEY, AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION 113–14 (2d ed. 2005); ALAN HIRSCH & DIANE SHEEHEY, AWARDING ATTORNEYS' FEES AND MANAGING FEE LITIGATION 109–10 (1994); BARBARA J. ROTHSTEIN & THOMAS E. WILLGING, MANAGING CLASS ACTION LITIGATION: A POCKET GUIDE FOR JUDGES 33 (3d ed. 2010); BARBARA J. ROTHSTEIN & CATHERINE R. BORDEN, MANAGING MULTIDISTRICT LITIGATION IN PRODUCTS LIABILITY CASES: A POCKET GUIDE FOR TRANSFEREE JUDGES 14 (2011); THOMAS E. WILLGING & NANCY A. WEEKS, ATTORNEY FEE PETITIONS: SUGGESTIONS FOR ADMINISTRATION AND MANAGEMENT 5–8 (1985).

which lead plaintiffs bargain with lawyers, the intensity of that bargaining, the terms that emerge, or the impact that ex ante fee agreements have on lawyers' fee requests. Filed documents rarely shed much light on these matters, probably because parties think judges have little interest in them.

This preliminary study does, however, supply information that may prove useful to judges, securities class action lawyers, and future lead plaintiffs, and it suggests directions for future research. After reading this Article, large institutional investors and the lawyers who represent them may be more eager to resolve fee-related matters when litigation begins and to present ex ante fee agreements to courts for in camera review when requesting control of class litigation. Judges' interest in ex ante fee agreements may also increase, and they may think it wise to evaluate these agreements when appointing lead plaintiffs and to give them greater weight when setting fees. In our view, these changes, which could be implemented without amending the PSLRA, would have two salutary effects. They would make the process of setting fees in securities-fraud class actions more transparent, and they would ground fee awards more solidly in prevailing market rates rather than in the intuitions and preferences of individual judges.

V. APPENDIX

Cases with Fee Cuts

Case	Court/ Judge	Lead Plaintiff Type	Gross Settlement (Millions)	Fee Request	Fee Award	Objections to Fee Request	Award/ Request Ratio	Reasons Given for Cut[122]
Cadence	N.D. Cal. Conti	Union Fund	$38	0.25	0.19	No	0.76	AB
Children's Place	S.D.N.Y. Scheindlin	Union Fund	$12	0.27	0.15	No	0.56	ABEF
Chiron	N.D. Cal. Walker	Union Fund	$30	0.25	0.15	Yes	0.61	ABCDF
Escala	S.N.D.Y. Hellerstein	Public Pension	$18	0.22	0.18	No	0.82	ABC
Forest	S.D.N.Y. Wood	Union Fund	$65	0.245	0.14	No	0.57	ABC
Globalstar	S.D.N.Y. Preska	Public Pension	$1.5	0.2	0.18	No	0.92	
Harmonic	N.D. Cal. Hamilton	Private Institution	$15	0.27	0.25	No	0.93	
Hexion	S.D.N.Y. Berman	Individual	$18	0.2	0.07	No	0.35	ABCEF
IMAX	S.D.N.Y. Buchwald	Private Institution	$12	0.25	0.19	No	0.76	ABCE
JA Solar	S.D.N.Y. Koeltl	Individual	$4.5	0.3	0.23	No	0.77	EF
Lehman	S.D.N.Y. Kaplan	Union Fund	$40	0.1925	0.13	No	0.67	ABCF
Magma	N.D. Cal. Breyer	Individual	$13.5	0.3	0.19	No	0.62	ACE
Nat'l Lampoon	C.D. Cal. Anderson	Individual	$1	0.33	0.25	No	0.75	ABCE
NexCen	S.D.N.Y. Cedarbaum	Individual	$4	0.3	0.21	No	0.71	ABCE
NovaGold	S.D.N.Y. Cote	Public Pension	$26.78	0.213	0.16	No	0.77	ABCE
Nuvelo	N.D. Cal. Breyer	Individual	$8.92	0.3	0.28	Yes	0.93	
RHI	S.D.N.Y. Hellerstein	Union Fund	$2.5	0.3	0.08	No	0.25	
Sadia	S.D.N.Y. Scheindlin	Union Fund/ Individual	$27	0.324	0.30	No	0.93	BCEF
ShoreTel	N.D. Cal. Breyer	Individual	$3	0.33	0.26	No	0.78	AE
SLM	S.D.N.Y. Pauley	Private Institution	$35	0.25	0.23	No	0.9	
Terayon	N.D. Cal. Wilken	Individual	$2.73	0.33	0.25	No	0.75	
TVIA	N.D. Cal. Whyte	Individual	$2.85	0.272	0.23	No	0.84	
UTStarcom	N.D. Cal. Illston	Individual	$9.5	0.33	0.25	No	0.75	BCF
Warner Chilcott	S.D.N.Y. Pauley	Union Fund	$16.5	0.275	0.18	No	0.65	BC

122. Reasons given for fee cut:
   - A. Requested fee too large.
   - B. Requested fee too large given work performed.
   - C. Requested fee too large given actual risk of nonrecovery.
   - D. Court cannot rely on market for attorneys' fees.
   - E. Requested fee is out of line with fees in similar cases.
   - F. Requested fee fails lodestar or other cross-check.